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No. 369

IN THE

Supreme Court of the United States

October Term, 1958

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE LASALLE & KOCH COMPANY,

Petitioners,

v.

UNITED STATES OF AMERICA.

PETITIONERS' APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS

	PAGE
Opinion Below	1
Judgment Below, Entered May 12, 1958	13
Opinion Below Denying Rehearing	14
Order Below Denying Rehearing, Entered June 16, 1958	17
Opinion of the District Court	18
Stipulation of Facts	41
Statutes, Regulations and Rulings:	
Statutes:	
Internal Revenue Code of 1939,	
Section 22(c)	63
Section 22(d)	63
Regulations:	
Regulations 103,	
Section 19.22(c)-8	65
Sections 19.22(d)-1 to 19.22(d)-6 before amendment by T. D. 5605	68
Sections 19.22(d)-1 and 19.22(d)-2 as amended by T. D. 5605	77
T. D. 5605, 1948-1 Cum. Bull. 16	79

PAGE

Rulings:

Mim. 6244, 1948-1 Cum. Bull. 21 83

Miscellaneous:

Press Release, United States Attorney for the Southern District of New York, July 7, 1958 89

Explanatory Note:

For the convenience of the Court, original Record pages are indicated in brackets in the materials contained in this Appendix, which are a part of the original Record certified to this Court.

Opinion Below

[67b] UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

———*———

No. 189—October Term, 1957.

(Argued March 10, 1958 Decided May 12, 1958.)

Docket No. 24710

———*———

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXSON CO., and THE LA SALLE & KOCH COMPANY,

Plaintiffs-Appellees,

—v.—

UNITED STATES OF AMERICA,

Defendant-Appellant.

———*———

Before:

CLARK, *Chief Judge,*
HINCKS, *Circuit Judge,* and BRENNAN, *District Judge.*

———*———

Appeal from the United States District Court for the Southern District of New York. Alexander Bicks, *Judge.*

Defendant, United States of America, appeals from a summary judgment, D. C. S. D. N. Y., 148 F. Supp. 377, for plaintiffs, R. H. Macy & Co., Inc., L. Bamberger & Co., Davison-Paxson Co., and The La Salle & Koch Company, in an action for the refund of income and excess profits taxes for the fiscal year 1942. Reversed and remanded for summary judgment for defendant.

Opinion Below

[68b] MORTON S. ROBSON, Asst. U. S. Atty., S. D. N. Y., New York City (Paul W. Williams, U. S. Atty., and Daniel F. McMahon, Asst. U. S. Atty., New York City, on the brief), *for defendant-appellant.*

ROSWELL MAGILL, of Cravath, Swaine & Moore, New York City (Albert Rosenblum, Charles T. Stewart, Nathan Dreizen, and George S. Parlin, Jr., on the brief), *for plaintiffs-appellees.*

———*———

CLARK, *Chief Judge*:

The defendant appeals from a summary judgment in favor of the taxpayer, Macy,[1] allowing it to recover income and excess profits taxes for the fiscal year 1942 and denying defendant's cross-motion for summary judgment. D. C. S. D. N. Y., 148 F. Supp. 377. The facts have been stipulated. At issue is whether Macy, in 1948, may recompute taxable income for the fiscal year 1942, using the "last-in, first-out" (LIFO) method of inventory, when it had failed to file an election to use that method within the time prescribed by the Commissioner of Internal Revenue.

In its operation of retail department stores Macy values inventories according to the retail method of inventory valuation which was, and still is, acceptable to the Treasury Department. Under this method, inventory records are maintained by each department in the store in terms of dollars, rather than in terms of specific articles of mer-

[1] R. H. Macy & Co., Inc., was the sole stockholder of L. Bamberger & Co., Davison-Paxon Co., and The La Salle & Koch Company. In 1948 these subsidiaries were liquidated, and their assets, including the tax refund claims here involved, were distributed to Macy, which hereinafter is treated as the sole plaintiff.

[69b] chandise.[2] Under any method of inventory, "costing" the closing inventory is a necessary step in the calculation of taxable income. FIFO and LIFO are alternative accounting methods for arriving at this cost. LIFO assumes that the last articles purchased during the year were the first ones sold, so that articles left in the inventory at the end of the year were the first ones purchased. FIFO (first in, first out) assumes the converse, that the earliest article purchased was the first one sold, so that articles left in the inventory at the end of the year were the last ones purchased. Obviously neither FIFO nor LIFO corresponds with actual fact, although the FIFO assumption seems more logical in the normal course of business operations. In a period of stable prices the application of either theory renders the same result. But during an inflationary period, LIFO is distinctly advantageous to the taxpayer, for, in effect, he is not required to include as profit increases in value of inventory. This illustrates the real purpose of the methods—to reflect accurately what normally is considered as profit during inflationary and deflationary periods in the economy.

Prior to 1939 only a limited class of taxpayers were permitted to use the LIFO method in calculating their federal taxes. The Internal Revenue Code of 1939, § 22(d), however, provided for its use by any taxpayer who complied with the requirements of the section. Two such requirements are at issue here: One, contained in § 22(d)(2)(A), required the taxpayer to make a binding application to use the LIFO method to be filed in a manner and at a time prescribed by the Commissioner. The other, contained in § 22(d)(3), required that the use of LIFO be in accordance

[2] For a detailed exposition of the "retail method," see *Hutzler Bros. Co.* v. *C. I. R.*, 8 T. C. 14, 15, 16.

with regulations which the Commissioner could prescribe as [70b] necessary so that the use of the method would clearly reflect income. The Commissioner implemented the statute with Regulations 103, § 19.22(d). This required that the taxpayer file a statement of election to use LIFO with his return for the taxable year in which the method was first to be used, thus following the direction of § 22(d)(2)(A). And it further elaborated on other portions of the statute by spelling out with greater specificity the statutory requirements incident to the use of LIFO.

Macy's directors decided to adopt the LIFO method and took many of the necessary steps to implement their decision. Its executive committee voted to adopt the method for the purpose of determining operating profit to be shown in its annual report, and its board of directors followed suit soon thereafter. In addition Macy kept its regular books of account for the fiscal year 1942 on a LIFO basis and in a prospectus relating to an issue of debentures it used LIFO to compute earnings for that fiscal year. Thus it seems apparent that Macy seriously was considering a change over to LIFO in its return for the fiscal year 1942 which was filed in July of that year.

Two factors, however, complicated the effectuating of this decision. First, Macy had issued during the fiscal year of 1942 an interim report which was not based on LIFO. As the statute existed prior to its amendment in October 1942, this barred Macy from using LIFO for that fiscal year. Second, as stipulated by the parties, the Commissioner and other representatives of the Treasury Department took the position that LIFO was not available to users of the retail method of inventory valuation, since such taxpayers determined their inventories in terms of dollar values, rather than in terms of specific goods. Evidently the Com-

missioner interpreted the language of the statute which permitted the use of LIFO in inventorying "goods" to pre-
[71b] clude its use by taxpayers who inventoried in terms of dollars. The argument is based on the fact that FIFO and LIFO deal in terms of specific articles of merchandise and thus appear to be inapposite to the retail method of inventory valuation, which deals in terms of dollar values. But this seeming inappropriateness is superficial when one considers the purpose of the theories—accurate reflection of profit—and essentially it is simple to apply the FIFO or LIFO assumptions to retail-method taxpayers. In the case of LIFO this consists roughly of adjusting the value of the closing inventory by price indices which reflect increases in value during the year.[3] These difficulties did not completely discourage Macy, however, for in its return for that fiscal year, which was timely filed on July 15, 1942, inventories were reported on the basis of LIFO, using retail price indices prepared by the National Industrial Conference Board. Macy adjusted the income and excess profits taxes due, however, so as to reflect the retail method of inventory valuation, without the application of LIFO, and paid its taxes on this basis. Thus Macy filed a "dual" return which reflected taxable income with and without the use of LIFO, but actually paid its taxes without using the theory.

The Internal Revenue Code of 1939 was amended the following October to remove the first difficulty. The regulations were amended in December to allow taxpayers previously barred from using LIFO because of their publication of inconsistent interim reports to elect LIFO for the

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[3] A method for making the adjustments once the proper indices are determined is illustrated in *Hutzler Bros. Co.* v. *C. I. R.*, 8 T. C. 14. See also *Edgar A. Basse* v. *C. I. R.*, 10 T. C. 328.

barred years by filing Treasury Department Form 970 prior to March 10, 1943. Macy was now in a position to effectuate its decision to adopt the LIFO method for the fiscal [72b] year 1942. But March 10, 1943, came and went without Macy filing the required notice of election, allegedly because of the Commissioner's opposition, which at that time had never been the subject of a formal ruling or decision.

Some seventy other retailers refused to acquiesce in the Commissioner's informal position, however, and they filed statements of election to use the LIFO method. In the absence of published price indices to adjust closing inventories, so as to make possible the computation of that portion of profit which was due to the year's price rise, these retailers used indices prepared by the National Industrial Conference Board, as had Macy in its original return for the fiscal year 1942. The Commissioner then took a formal stand disallowing the use of LIFO by "retail method" taxpayers. The issue came to a head in 1947 when the Tax Court in *Hutzler Bros. Co.* v. *C. I. R.*, 8 T. C. 14, 28, decided in favor of the taxpayer and held that the statute contemplated the use of LIFO by taxpayers who valued inventory according to the retail method. The court interpreted the word "goods" as used in §§ 22(d)(1) and (2) broadly as merchandise "describing in the generic sense the stock in trade of a typical department store." The court also held that, regardless of the Commissioner's position, his "regulations are as consistent with petitioner's position as they are with that of respondent." *Ibid.* This statement obviously was directed at § 19.22(d)-2 of the regulation which referred to "goods" to be inventoried. The court suggested, however, that the Commissioner issue new regulations consistent with its opinion. The Commissioner acquiesced in

the decision and, possibly because of the court's suggestion, issued amendments to the regulations. The major change by way of amendment was to add information concerning acceptable price indices. In addition the amendments removed any question as to the applicability of § 19.22(d)-2 [73b] to retail method taxpayers. The amendments were retroactive to all taxable years beginning after December 31, 1938. Shortly thereafter the Commissioner issued Mim. 6244, 1948-1 C. B. 21, stating in detail proper price indices and providing that retailers who previously had filed returns on the basis of LIFO using unacceptable indices could thereafter file amended returns for all "open" years based on indices acceptable to the Commissioner.

In September or October 1948, Macy filed notices of election to use LIFO for the fiscal year 1942, together with claims for refund of taxes paid for that year. In 1948 this year was still an "open" year for purposes of claiming refunds. In early 1951 Macy requested a ruling on its election and claim. Eventually, in 1954, the Commissioner ruled adversely to it on the ground that it had failed to file a notice of election to use LIFO for the fiscal year 1942 on or before March 10, 1943, as required by the regulation.

Macy contends that it was not required to file an election on that date, because the whole regulation which the Commissioner issued to govern the use of LIFO was inapplicable to it, a taxpayer using the retail method of inventory valuation. Both Macy and the government agree that the statutory right to elect LIFO was not absolute, but was conditioned upon compliance with appropriate regulations to be issued by the Commissioner pursuant to §§ 22(d)(2)(A) and (3). There is little argument with respect to the regulation designed to implement § 22(d)(2)(A), for it clearly sets forth the time and manner of filing applications to use LIFO. But Macy points to § 22(d)(3)

of the Act, which provides that "[t]he change to, and the use of, [the LIFO] method shall be in accordance with such regulations as the Commissioner * * * may prescribe as necessary in order that the use of such method may clearly reflect income." It then contends that § 19.22(d)-2 of the [74b] regulation, which purportedly was issued to implement § 22(d)(3), did not permit the inventorying of goods by departments or classes or provide price indices to convert the retail method inventory figure to a LIFO figure, and thus prohibited LIFO to taxpayers who used the retail method of inventory valuation. Therefore it claims that as the regulations relating to the change to, and the use of, LIFO were not applicable to it, the regulations relating to time and manner of election were likewise inapplicable until 1948 when they were amended.

Macy's conclusion does not withstand a careful analysis of the statute and the regulations. First, Regulations 103, § 19.22(d)-1 specifically provided that "[a]ny taxpayer permitted or required to take inventories pursuant to the provisions of Section 22(c) and pursuant to the provisions of Sections 19.22(c)-1 to 19.22(c)-8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by Section 22(d) [the LIFO method]." Section 19.22(c)-8 of the regulations, referred to above, permitted retail merchants to employ the retail method. Thus the LIFO regulations specifically stated that taxpayers like Macy could use the LIFO method to compute opening and closing inventories.

Second, at least two other courts have held that the LIFO regulations were applicable to "retail method" tax payers. In *Hutzler Bros. Co.* v. *C. I. R.*, *supra*, 8 T. C. 14,

the Commissioner argued that his interpretive regulations showed the statute did not permit the use of LIFO by a taxpayer like Macy and in fact barred such use. But the Tax Court rejected this argument and held that the regulations were "ambiguous and largely irrelevant administrative interpretations" of the statute and that they supported the [75b] taxpayer's contentions as much as those of the Commissioner. 8 T. C. 14, 28. And this is a logical result, for initially the Commissioner believed that the words of the statute made it inapplicable to taxpayers who used the retail method of inventory valuation. Therefore he cast his regulations in the same words which ultimately were held to allow use of LIFO by such taxpayers. When the court rejected the Commissioner's interpretation of the statute it simultaneously rejected his interpretation of similar words used in his regulation which rendered it no bar to the use of LIFO by "retail method" taxpayers.[4]

In the other case, *Kaufman & Baer Co.* v. *United States*, 133 Ct. Cl. 510, 137 F. Supp. 725, certiorari denied 352 U. S. 835, a plaintiff, which used the retail method of inventory valuation, filed its federal tax return for the fiscal year 1942 on the basis of FIFO. It later filed an election to use LIFO for that fiscal year, as permitted by the amendment to § 22(d), which removed the prohibition contained

[4]Macy contends that requirements contained in § 19.22(d)-2 of the regulations were inapposite to the retail method of inventory valuation and in effect prohibited it from using LIFO. The section required the filing of an application "specifying with particularity the goods to which it [LIFO] is to be applied," and provided that goods included in the opening inventory "shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand." The short answer to Macy's argument is that the statute, § 22(d), which the Tax Court held applicable to "retail method" taxpayers, used similar language. See especially §§ 22(d)(1) and (2). Certainly Macy does not argue that this statutory language prohibits its use of LIFO.

in the original statute against the adoption of LIFO for a year during which a taxpayer issued interim reports on a non-LIFO basis. But it filed its election late—nearly a month after the cut-off date set out in the LIFO regulation. A claim for refund accompanied the election. Shortly afterwards plaintiff wrote to the Commissioner and indicated its desire to withdraw the election and the claim for refund. [76b] As now, the statute and the regulations permitted revocation of an election to use LIFO only with the approval of the Commissioner. The Commissioner, without referring to the purported revocation, denied the claim for refund. The plaintiff, treating its revocation as a nullity (because it did not have the Commissioner's approval), later commenced an action to recover the refund due upon its recalculation of taxes for the fiscal year 1942, using LIFO, rather than FIFO. The court found it unnecessary to decide whether plaintiff's attempt to revoke was effective, for it specifically held that in any case plaintiff's election was not timely made. Thus the court necessarily held that the regulations were applicable to a "retail method" taxpayer. The learned trial judge in the case at bar was in error in labeling this holding "*obiter dicta.*"

Third, a regulation setting forth acceptable price indices to enable Macy to convert closing inventories to LIFO was unnecessary under the statute. Section 22(d)(3) permitted but did not require the Commissioner to issue regulations governing the change to, and use of, LIFO so that its use would clearly reflect income. Thus the Commissioner was under no duty to issue a specific regulation prescribing the accounting methods to be used by "retail method" taxpayers to enable them to adopt LIFO. In the absence of such a regulation these taxpayers were free to adopt any method which they believed proper, subject of course to the Commissioner's approval. Certainly Macy was not prejudiced

by this procedure, for it, together with other retailers, had price indices prepared by the National Industrial Conference Board which it used for its annual report. And these same indices were used by Hutzler Brothers Company in its return for the fiscal year 1942. The fact that the Commissioner only in 1948 came to issue information concern- [77b] ing acceptable indices is of no moment. He had the discretion to do this at any time he chose.

Ultimately Macy's argument is that it failed to file a timely election because the Commissioner maintained the position that LIFO was not available to users of the "retail method." Although this argument evokes a certain sympathy it is unavailing as an excuse for Macy's delinquency. As Judge Littleton said in *Kaufman & Baer Co.* v. *United States, supra*, 133 Ct. Cl. 510, 137 F. Supp. 725, 730, certiorari denied 352 U. S. 835: "The Commissioner's interpretation of the applicable sections to mean that retailers using dollar totals rather than specific items could not use the LIFO method was erroneous. If the plaintiff wanted to use the LIFO method it should have filed its returns on that basis and have made a timely election to use the method, as did other taxpayers. The Commissioner's failure to act on the election to use LIFO did not prejudice plaintiff. It could have sought action by the Commissioner or from the courts if it desired." Hutzler Brothers Company and some seventy other similarly situated taxpayers took the necessary steps and ultimately succeeded. They were bound by their 1942 elections to use LIFO thereafter, while Macy, if it were successful here, would have had the benefit of six years' hindsight in deciding whether or not to elect LIFO for the fiscal year 1942.

In summary, Macy, if it chose to avail itself of the LIFO method for the fiscal year 1942, had to file its application

at the time and in the manner prescribed by the Commissioner. His valid and applicable regulation required an election on or before March 10, 1943. Macy failed to meet this requirement. It is no excuse that this failure occurred because the Commissioner opposed Macy's exercise of its statutory right or a succeeding Commissioner erroneously considered the excuse valid. Not thus is the United States [78b] of America to be estopped in the collection of its revenue. *Automobile Club of Michigan* v. *C. I. R.*, 353 U. S. 180, 183-184. Accordingly the lower court erred in awarding summary judgment to Macy.

Reversed and remanded for summary judgment for defendant.

Judgment Below

[79b] UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

———*———

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 12th day of May one thousand nine hundred and fifty-eight.

Present:

HON. CHARLES E. CLARK,
Chief Judge
HON. CARROLL C. HINCKS
HON. STEPHEN W. BRENNAN,
District Judge

R. H. MACY & COMPANY, INC.,
BAMBERGER & COMPANY, *et al.*,
Plaintiffs-Appellees,

—v—

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and action remanded for summary judgment for defendant, in accordance with the opinion of this court.

A. DANIEL FUSARO,
Clerk

Opinion Below Denying Rehearing

[129b]

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 189—October Term, 1957.

(Petition filed May 27, 1958 Decided June 16, 1958.)

Docket No. 24710

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE LA SALLE & KOCH COMPANY,
Plaintiffs-Appellees,

—v.—

UNITED STATES OF AMERICA,
Defendant-Appellant.

Before:

CLARK, *Chief Judge,*
HINCKS, *Circuit Judge,* and BRENNAN, *District Judge.*

On Petition for Rehearing.

CRAVATH, SWAINE & MOORE, New York City (Roswell Magill, George G. Tyler, Nathan Driezen, Charles T. Stewart, Edward O. Carr, Jr., George S. Parlin, Jr., and Albert Rosenblum, of counsel), *for plaintiffs-appellees.*

CLARK, *Chief Judge:*

Plaintiffs-appellees urge as a basis for rehearing of our reversal of the judgment below in their favor that the recent

[130b] decision of the Court of Claims in *Joseph Horne Co.* v. *United States*, Ct. Cl., May 7, 1958, is in conflict with our disposition of this case in that it implicitly rejects the prior decision of that court in *Kaufmann & Baer Co.* v. *United States*, 133 Ct. Cl. 510, 137 F. Supp. 725, certiorari denied 352 U. S. 835, which we cited as holding that the pre-1948 LIFO regulations were applicable to "retail method" taxpayers. But a careful consideration of the cited case convinces us that this contention is without merit. There is nothing to suggest that the court there thought it was overruling its earlier decision, which is not even cited in either the prevailing or the dissenting opinion. Actually this late case deals with a different statutory provision and a different situation—that of "involuntary liquidation"—than our present issue. Concededly it can be applicable only by a process of reasoning by implication and analogy which we find unpersuasive.

The issue in the *Horne* case was whether Congress intended, in passing in 1950 as an amendment to I. R. C. 1939, § 22(d)(6)(A), 64 Stat. 592, Pub. L. 756, 81st Cong., 2d Sess. (1950), to allow taxpayers like Horne the use of the involuntary liquidation provisions therein contained for tax years prior to 1948. Neither the Public Law nor § 22(d)(6)(A) is applicable to the problems raised in this case, which are governed by I. R. C. 1939, § 22(d)(2) and (3). The provisions involved in the *Horne* case were for the benefit of LIFO users; and Horne, unlike Macy, filed a timely election to use LIFO in 1942 and filed its returns for the years in question on that basis. It failed, however, to file the required elections to invoke the involuntary liquidation privileges because the system of indices that it used to convert its inventories to LIFO (storewide indices) did not disclose the so-called involuntary liquidations. When in 1948 the Commissioner of Internal Revenue

published acceptable indices (based on departmental, rather [131b] than storewide, experience) Horne recalculated its prior conversions and discovered involuntary liquidations in certain departments which it then wished to utilize for their tax benefits. It was foreclosed from doing this because of its failure to make timely elections in the past. Congress then passed 64 Stat. 592, and the Court of Claims held that by it Congress intended to provided relief for taxpayers like Horne which did file timely elections to use LIFO, but computed inventories on other than the acceptable departmental bases.

Macy argues that Horne could not have prevailed in the Court of Claims unless the pre-1948 regulations were inapplicable to "retail method" taxpayers. It seems to be saying that if the regulations applied, Horne had to comply with them by filing inventories using departmental price indices which would have disclosed involuntary liquidations. Obviously, however, prior to 1948 the Commissioner, in his discretion, had issued no regulations stating acceptable indices. Therefore prior to 1948 Horne could use any method subject to the Commissioner's approval, and storewide indices were conditionally acceptable. Thus Horne's proper compliance with applicable regulations did not show involuntary liquidations. So the Court of Claims decided that Congress intended to give relief to taxpayers who otherwise would be harmed by the Commissioner's failure to publish acceptable indices sooner. Its conclusion is not at all inconsistent with its holding in the *Kaufman & Baer Co.* case that the LIFO regulations were applicable (as far as they went) to retail method taxpayers prior to 1948; nor is it inconsistent with our disposition of the present appeal. The other points raised in the petition for rehearing were previously considered and rejected by us.

Petition denied.

Order Below Denying Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the sixteenth day of June, one thousand nine hundred and fifty-eight.

Present:

HON. CHARLES E. CLARK,
Chief Judge,

HON. CARROLL C. HINCKS,
Circuit Judge,

HON. STEPHEN W. BRENNAN,
District Judge

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE LASALLE & KOCH COMPANY,
Plaintiffs-Appellees,
v.
UNITED STATES OF AMERICA,
Defendant-Appellant.

A petition for a rehearing having been filed herein by counsel for the appellees,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

[32a] **Opinion of the District Court**

(87)

[SAME TITLE]

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OPINION

BICKS, *D. J.*

In this action for refund of Federal income (88) tax and declared value excess profits tax[1] for the fiscal year [33a] ended January 31, 1942, plaintiffs have moved for summary judgment and the defendant has cross moved for

[1]The complaint seeks a refund in the aggregate amount of $727,523.46. The parties have stipulated, however, that the exact amount will be computed subsequent to the decision on the merits

similar relief. The determinative facts having been in the main stipulated, the decision turns upon the construction and applicability of the Regulations promulgated by the Commissioner of Internal Revenue under Section 22(d) of the Internal Revenue Code of 1939.

The plaintiffs[2] (hereinafter referred to as Macy) owned and operated large retail department stores. For many years prior to the fiscal year ended January 31, 1942 Macy employed the so-called retail method of pricing or (89) evaluating its inventories; a method approved[3] by the Treasury Department and in general usage by department store operators. Under that method inventories are taken in terms of selling price dollar values rather than by specific items of merchandise with the consequence that goods in a single department are treated for inventory purposes as being entirely fungible, although in fact they may, and generally do, differ considerably as to type, [34a] quality, and price.[4] In costing a closing inventory it becomes necessary to resort to an assumption as to what goods with what costs have been sold during the year and

[2]R. H. Macy & Co. Inc. was the sole stockholder of plaintiffs L. Bamberger & Co., a New Jersey corporation, Davison-Paxon Co., a Georgia corporation and The LaSalle & Koch Company, an Ohio corporation. On January 31, 1948 the subsidiary corporations were completely liquidated, and their property and assets, including the tax refund claims involved in this suit, were distributed to Macy in complete cancelation and redemption of all of its stock in each of said subsidiaries. Although under the law of its state of incorporation the corporate existence of each of said subsidiaries has continued to date for the purpose of suing and being sued, the parties have stipulated that in the event it is held the plaintiffs are entitled to refunds, judgment for the entire amount thereof may be entered in favor of Macy on its own behalf and as successor of said subsidiary corporations.

[3]I.D. 3058, 3 C.B. 72, (1920); Regulations 111, sec. 29.22 (c)-8.

[4]For a review of the characteristics of the retail method see *Hutzler Brothers Company v. Commissioner of Internal Revenue*, 8 T. C. 14 (1947).

what goods with what costs remain on hand. One of two assumptions might be used: (1) that an article of merchandise "first in", *i.e.*, the article purchased earliest, was the first one sold and that the articles left in the inventory at the end of the year were purchased last, the so-called FIFO method; or (2) that an article of merchandise "last in", *i.e.*, the article last purchased, was the first sold and that the articles left in the closing inventory were the articles first purchased, the so-called LIFO method. Neither assumption can be entirely true; but it is essential to use one or the other (90) as the basis for the retail method.[5]

As long as the price structure remains relatively stable the FIFO method gives satisfactory results. In an era of inflation the method of inventory valuation looms importantly in determining taxable income. During such a period, the cost of goods sold, if values as reflected in the opening inventory are employed, will be lower and the gross profit on sales greater than would be the case if the cost of goods sold were determined under the LIFO method. Under FIFO, in periods of rising prices, taxable income may include profits that result merely from the increase in the value of the inventory on hand; whereas under LIFO such book profits are excluded. Increase in corporate tax rates, the steadily increasing rise in prices and the depreciating value of currency that accompanied the dis- [35a] turbed conditions in Europe immediately preceding World War II underscored the importance of this problem. The Congress recognized it by granting taxpayers permission to elect to use the LIFO method. As first enacted[6] permission to use the elective method was confined to taxpayers in certain industries, *e.g.*,

[5]The need to indulge in either of these assumptions exists generally—though not universally; it is not confined to taxpayers who use the retail method of inventory valuation.

[6]Revenue Act of 1938, § 22(d), 52 Stat. 459 (1938).

(91) producers and processors of certain non-ferrous metals and tanners of hides and skins.[7] In 1939 this permission was extended to all taxpayers.[8] Section 22(d) of the Revenue Act of 1939, so far as here pertinent, provides as follows:

> (d) METHOD OF INVENTORYING GOODS. (1) A taxpayer may use the following method [*i.e.*, the elective method] in inventorying goods specified in the application required under paragraph (2): (A) *** (B) *** (C) ***
>
> (2) The method described in paragraph (1) may be used—
>
> (A) Only in inventorying goods * * * specified in an application to use such method filed at such time and in such manner as the Commissioner may prescribe; and
>
> (B) Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that [36a] specified in * * * paragraph (1) in inventorying (to ascertain income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to (92) beneficiaries) such goods for any period beginning with or during the first taxable year for which the method described in paragraph (1) is to be used.
>
> (3) The change to, and the use of, such method shall be in accordance with such regulations as the Com-

[7] It is demonstrable that this was intended as an ameliorative measure rather than as an aid for accurate ascertainment of the date of purchase of the goods in the closing inventory. For example, in industries where the prime raw material is leather requiring processing, it is a physical impossibility for the raw leather last in to be the first out.

[8] Revenue Act of 1939, § 22(d), 53 Stat. 11 (1939).

missioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

The provision in subdivision (2)(B), precluding the use of the elective method by a taxpayer who *during* the first taxable year for which it is sought to be used employed some other method "* * * for the purpose of reports to shareholders * * *", was amended in 1942[9] retroactively to taxable years beginning after December 31, 1938, to interdict the use of the elective method by taxpayers who used some method other than LIFO "* * * for the purpose of a report or statement *covering* such taxable year". The effect of the amendment was to make the elective method available notwithstanding the issuance of an interim report prepared on another basis.

In December 1939 the Commissioner of Internal Revenue promulgated Regulations pursuant to Section 22(d). From almost the very outset and until 1948 he and other representatives (93) of the Treasury Department and the Bureau of Internal Revenue took the position that the statutory grant of leave to use the LIFO method was not [37a] applicable to users of the retail method. The Commissioner's rationale, as stipulated by the parties, was that since users of the retail method determined their inventories in terms of dollar values rather than in terms of specific goods[10] the specificity of the inventoried goods required by Section 22(d) I. R. C. was lacking. Accordingly, in view of the then thinking of the Commissioner and other

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[9]Revenue Act of 1942, § 118, 56 Stat. 814 (1942).

[10]It has been stipulated that due to the multiplicity of items carried by retail department stores and the varying price ranges of those items, it is not practicable to account for the inventories of those stores on an item basis.

representatives of the Treasury Department,[11] the Regulations did not make the necessary provisions to permit application of LIFO to users of retail method.[12]

(94)

In 1942 Macy and other retailers, as well as representatives of the National Retail Dry Goods Association, held conferences with representatives of the Treasury Department and the Bureau of Internal Revenue for the purpose, among others, of persuading those agencies to abandon their position that users of the retail method did not fall within the class of taxpayers qualified to adopt the elective method. In anticipation that their efforts would meet with success, the Macy management decided to adopt [38a] LIFO for the purpose of its Annual Report to its Stockholders for the fiscal year ended January 31, 1942.[13]

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[11] "* * * many taxpayers are unable to use the last-in first-out method, particularly taxpayers whose inventory consists of a large number of different products rather than a few homogeneous products," Statement on June 15, 1942 by Randolph E. Paul, tax advisor to the Secretary of the Treasury before the House Ways and Means Committee.

[12] "Until after the decision in *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14, the Commissioner had issued no regulations with respect to the computation under the 'LIFO' method by a taxpayer using the retail inventory method." *Louis Pizitz Dry Goods Co.* v. *Deal et al.*, 208 F. 2d 724, 727 (5th Cir. 1953).

[13] In said Annual Report Macy advised its stockholders: "Your Corporation has decided to adopt for book purposes the so-called LIFO (last-in first-out) method of inventory valuation. The adoption of this method will serve to reduce in some measure distortion of annual earnings due to appreciation and depreciation in inventory values during a period of extensive changes in price levels. Our previous method of valuing inventories was 'cost or market, whichever is lower' as determined by the retail method. Under our present practice the LIFO method has been used to determine cost * * * Under existing provisions of the federal tax laws, the LIFO method may not be used by these companies for tax purposes, but it is believed that retroactive legislation will be enacted permitting its use for the year covered by this report."

For the purposes of said Report the opening inventories were arrived at by use of the retail method and the LIFO adjustments in connection with the closing inventories were based upon an index of retail price changes prepared by the National Industrial Conference Board. Plaintiff's regular books of account were kept on the same basis. The taxes shown on its tentative United States Income and (95) Declared Value Excess Profits Tax Returns for such fiscal year which were filed in April 1942 likewise were computed on the LIFO method. The final returns, timely filed in July 1942,[14] were prepared under the LIFO method, but the taxable incomes shown thereon were adjusted to what they would have been had the inventories been valued according to the retail method without the [39a] application of LIFO thereto.[15] By so doing Macy did not abandon its resolve to adopt LIFO. Its every act evidences the contrary. Witness: the numerous conferences with highly placed representatives of the Treasury Department and Bureau of Internal Revenue;[16] the (96) action of the Macy Executive Committee[17] and of the Macy Board

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[14]Several extensions of time were obtained in the expectation that in the intervening period either the Commissioner would recede from his position or amendatory legislation would be enacted granting relief to retailers.

[15]In the returns as filed the inventories were reported on the LIFO basis. Additions to taxable income attributable to the valuation of inventories on the FIFO method rather than on the LIFO method were made by appropriate adjustments in other sections of the returns.

[16]Such conferences were held on February 17, March 19, April 6, 7, 14, June 4 and July 20, 1942. At each of them the Macy representatives urged the Government representatives, *inter alia*, to abandon their opposition to the use of LIFO by users of the retail method.

[17]"LIFO—a method of evaluating merchandise inventories (Last-in First-out) was discussed and it was decided to adopt this method for the purpose of determining the operating profit to be reflected in the Stockholders Annual Report for the year

of Directors;[18] and the use of the LIFO method in computing its earnings for the purpose of the prospectus dated May 25, 1942 relating to a $12,000,000. [40a] issue of (97) 2½% Sinking Fund Debentures.[19] Furthermore, when the (98) final returns were filed Macy was ineligible to adopt the elective method of inventory valuation since it had issued a semi-annual report to stockholders during the fiscal year 1942 on the old basis. As already indicated the Regulations were amended in December 1942 removing this disqualification. However, the amended Regulations again failed to make any provision for adjustment to the LIFO basis of inventories taken on the retail method.

The Commissioner persisted in his position adverse to the views urged upon him by Macy and other retailers until the Tax Court of the United States decided in

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1941. However with respect to the Federal Income Taxes, it was decided to ask for a sixty-day extension, and if need be for a second sixty-day extension, so that we would be able to study the new tax law before filing a final Federal Income Tax return." Extract from minutes of a meeting of the Executive Committee, held on March 20, 1942.

[18] "The Treasurer reported that, after full consideration of the matter, the Executive Committee at its meeting on March 20, 1942, had decided to recommend that the so-called 'LIFO' (Last-in First-out) method of valuing inventories of the Corporation and its subsidiaries be adopted for purposes of the Annual Report to stockholders for the fiscal year ended January 31, 1942; and that decision as to the method of valuing inventories for tax purposes for that year be deferred pending further study of the matter in the light of possible amendments to the tax laws relative thereto." Extract from minutes of meeting of Board of Directors held on March 25, 1942.

[19] Note (D) to the Consolidated Profit and Loss Statement contained in said Prospectus in part states: "Under the present federal tax law and regulations issued thereunder, a taxpayer may use the Lifo method of inventory to determine taxable income if such taxpayer has used no other inventory method for certain purposes, including reports to stockholders, during the year for which the Lifo method is to be adopted. As the Corporation has issued a semi-annual report

[41a] *Hutzler*[20] that adaptation of the LIFO theory to inventories maintained in terms of dollars was permissible and proper within the provisions of Section 22(d) of the

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to stockholders for the six months ended August 2, 1941 on the old basis, it is prevented from using the Lifo method in the determination of taxable income for the year ended January 31, 1942. However, on March 4, 1942 Mr. Randolph Paul, Tax Advisor of the Secretary of the Treasury, in testifying before the Ways and Means Committee of the House of Representatives, stated that 'as the interim report requirement serves no real purpose and operates to discriminate unfairly between taxpayers who follow the practice of issuing interim reports and those who do not, it is suggested that the requirement be eliminated, and that the elimination be made retroactive to 1941.'

"Even if this provision relating to semi-annual reports is eliminated retroactively, two further factors must be considered in connection with the adoption of the Lifo method for tax purposes, as follows: (1) It is not clear whether the present tax law permitting the use of the Lifo method of inventory requires specific identification of goods in inventory and, if so, whether retailers carrying a large number of varying types of merchandise could meet that requirement. (2) Under the present law the adoption of the Lifo method would limit these companies to the use of 'cost' and would deprive them of the right to use 'cost' or market, whichever lower' which they have used for a long period of years.

"Convinced that the important test for the application of the Lifo method of inventory is investment in inventory rather than a particular method of bookkeeping, these companies have joined with others in the retailing industry in an effort to obtain retroactive legislation which would clarify the first of the above factors and obviate the second, in the following manner: (1) By specifically providing that, in determining cost, taxpayers with inventories of varying character and quality, impractical to identify, state, or reduce to common physical units, may state such inventories under the Lifo method on the basis of dollar investment adjusted for variations in price levels. (2) By allowing the use of 'cost or market, whichever lower' under the Lifo method, just as it is now allowed under the present retail method of inventory, as the Lifo method is merely another method of determining cost.

"Conferences have been held with representatives of the Treasury Department in an endeavor to obtain their recommendation that Congress enact the desired remedial legislation of a retroactive character. These discussions are continuing."

[20] 8 T. C. 14 (1947).

Internal Revenue Code. Thereafter on March 4, 1948, the Commissioner amended the regulations retroactively to all taxable years beginning after December 31, 1938 "* * * in order to adapt the retail inventory requirements of the regulations to the elective inventory principle of Section 22(d) of the Internal Revenue Code as enunciated by the Tax Court of the United States in * * *" the *Hutzler* case. T. D. 5605, 1948—1 C. B. 16, 17. There then appeared for the first time authorized statistical price indices for use by retailers such as Macy in adjusting (99) inventories taken on the retail method to the LIFO method. I. T. 3904, 1948—1 C. B. 18.

After promulgation of the amended regulations, Macy, [42a] in October 1948, filed claims for refund[21] of so much of the income tax and declared value excess profits tax it paid for the fiscal year 1942 as resulted from the Commissioner's failure and refusal to make the use of LIFO available to it.[22] Together with each such claim Macy filed an application for the adoption and use of the elective inventory method on the form provided for that purpose by the Treasury Department (Form 970).

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[21]The amended Regulations were, by their terms, made retroactively applicable to all taxable years beginning after December 31, 1938 that were not then barred by the applicable Statute of Limitations contained in Section 322(b) of the Code. In October 1948 Macy's fiscal 1942 was an open year.

[22]Another set of refund claims were filed by Macy on the ground that it was entitled, in valuing inventories for the fiscal year involved in this suit, to take into account the involuntary liquidation and replacement provision contained in Section 22(d)(6) of the Code. In view of the stipulation of the parties that if the Court finds there was a timely election of LIFO for tax purposes then there has also been a timely election under the involuntary liquidation provisions, the claims based on the latter provisions will not be treated separately.

Under date of January 15, 1951, Macy addressed a communication to the Commissioner in which rulings were requested to the effect that (i) if its refund claims for fiscal 1942 and subsequent years are finally disallowed, then it made an election to adopt LIFO for the fiscal year (100) ended January 31, 1948 and (ii) the granting of ruling (i) will not jeopardize the claims for refund for the earlier years. Macy received a reply from the Treasury Department dated January 31, 1951, signed "E. I. McLarney, Deputy Commissioner," stating in part that under even date the Internal Revenue Agent in Charge, Upper New York Division, New York, is being advised with respect to the position of the Commissioner "regarding your claims for refund filed upon the above-mentioned [43a] basis [use of the LIFO inventory method]. Accordingly, the requested rulings will not be issued at this time." The letter of even date from the Deputy Commissioner to the Internal Revenue Agent in charge recommended that Macy's right to use LIFO, beginning with the taxable year ended January 31, 1942, be recognized.[23] There then followed an audit of Macy's tax return for the 1942 fiscal year and a letter from the Internal Revenue (101) Agent

[23] The text of said letter in full is as follows: "Returned herewith are the files of the above-mentioned taxpayers for the taxable years ended January 31, 1943 to 1948, inclusive, and July 31, 1949, which were previously forwarded to this office at the request of Mr. C. W. Stowe, Assistant Deputy Commissioner. There also is enclosed the file for the taxable year ended January 31, 1941.

"With reference to the taxpayer's claims for refund, based upon the definitive steps taken in 1942 to adopt and use the Lifo inventory method, it is the opinion of this office that the taxpayer's failure to report taxable income on the basis of Lifo inventory values as reflected on its books was due to the Bureau's position of nonrecognition of the right to so report for Federal income tax purposes. Accordingly, the provisions of I.P.M. No. 448 are considered inapplicable to this case, and it is recommended that the taxpayer's right to use Lifo, beginning with the taxable year ended January 31, 1942, be recognized."

in Charge transmitting the audit report of the Revenue Agent. This report allowed Macy to use the LIFO method in computing its income tax and declared value excess profits tax and proposed appropriate over-assessments in favor of Macy.[24]

Despite the foregoing action by the Deputy Commissioner, the Internal Revenue Agent in charge and the Revenue Agent, the Commissioner of Internal Revenue in office in 1954, ruled that Macy had not met the require-
[44a] ments for adoption of the elective method and disallowed the claims for refund.[25] The requirements which Macy failed to meet were not indicated. It appears, however, that the Commissioner's sole reliance is upon the omission to file Form 970 with the 1942 return or prior to March 10, 1943. The issue narrows itself down, therefore, to whether such omission under the circumstances of this case, is fatal.
(102)

There is nothing explicitly in the Statute which requires such holding. Congress did not fix the time for filing the notice of election to adopt LIFO as it did with respect to the notice of election to apply the involuntary liquidation and replacement of inventory provisions of the same statute. See Section 22(d)(6)(A). It authorized the Commissioner to prescribe the time and manner for filing

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[24]The preliminary Statement to the Revenue Agent's Report recites that "[t]he net overassessment is due to valuing of inventories on the elective inventory basis and replacement of goods involuntarily liquidated".

[25]In view of the absence of newly discovered facts, fraud or mistake or error of law Macy argues that the present Commissioner did not have the power to reverse his predecessor's determination. [Citing cases: *N. S. D. Co.* v. *Kavanagh*, 191 F. 2d 831 (6th Cir. 1951); *Woodworth* v. *Kales*, 26 F. 2d 178 (6th Cir., 1928); *Penrose* v. *Skinner*, 298 Fed. 335 (D. C. Col. 1923)]. The basis on which this decision rests, however, renders consideration of this point unnecessary.

an application to use the LIFO method [Section 22 (d)(2)(A)] as well as the qualifications for the change to, and use of, that method [Section 22(d)(3)].

Pursuant to the authority thus conferred, the Commissioner—in December 1939—issued Regulations 103, Sections 19.22 (d)-1 to 19.22 (d)-6 inclusive. Within a relatively short time after these regulations were promulgated the Commissioner asserted his view, later acknowledged to be erroneous, that the elective method was not available to users of the retail method of inventory valua- [45a] tion.[26] He therefore did not (103) issue any regulations relating to adjustment of inventories theretofore taken on the retail method to a LIFO basis, either by use of a statistical price index or otherwise. This much is not denied.

Pointing to subdivision 3 of section 19.22 (d) of the Regulations, as amended by Treasury Decision 5199, 1942-2 C. B. 81, approved December 10, 1942,* the Com-

[26] In Mim. 6244, 1948-1 C. B. 21 (March 9, 1948), the Commissioner stated in part:

"1. Section 22(d)(1) of the Internal Revenue Code provides an elective method for inventorying goods, commonly referred to as the last-in, first-out, or LIFO, inventory method. Section 22 (d)(2)(A) of the Code provides that the elective method shall be applied only with respect to the goods specified by the taxpayer in an application filed with the Commissioner. The Commissioner's regulations with respect to the elective inventory method have heretofore made no provision for retailers to group such goods into classes. The Bureau has held that the use of the elective inventory method was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method permitted under Section 29.22(c)-8 of Regulations 111 and Section 19.22(c)-8 of Regulations 103."

*The pertinent part of this subdivision reads as follows: "Time and manner of making election.—The elective method may be adopted and used if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or * * *) in triplicate on Form 970 (revised), and pursuant to the instructions prescribed thereon and to the requirements of this section, a statement of his election to use such method * * *"

missioner argues that notwithstanding his refusal to issue any regulation appropriate to accomplish the general purpose of applying the LIFO method to retail merchants and his inflexible position that the elective method was not available to them, he did provide for the manner and time within which they should file a statement of election to use such method. Consequently, the Commissioner concludes, Macy's omission to file Form 970 within the [46a] time fixed in that subdivision effectively bars its right to recover in this suit.
(104)

Read *in vacuo* and isolated from the other subdivisions of section 19.22 (d), subdivision 3 is susceptible of the use to which the Commissioner would make of it here. Viewed in its entirety,[27] however, and against the background of the Commissioner's position that users of the retail method did not qualify under subdivision 2 to adopt the elective method, such use does violence to and is out of harmony with the intendment of section 19.22 (d). Unless subdivision 3 modifies subdivision 2 or supplies the void in the regulations pointed up in *Hutzler*, and the Commissioner does not so argue, subdivision 3 read together with subdivision 2 fixes the time and manner of filing the statement of election to use LIFO by taxpayers qualified under the Regulations to make that election.

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[27] Single provisions and single sentences are not to be selected and construed by themselves, but the whole must be studied together. See *Koppers Conn. Coke Co. v. James-McWilliams Blue Line*, 18 F. Supp. 992 (E. D. N. Y. 1936), aff'd 89 F. 2d 865, cert. denied 302 U. S. 706; see also, *Glenn v. U. S.*, 129 F. Supp. 914, 919 (S. D. Cal. 1955); *Adler v. Northern Hotel*, 175 F. 2d 619, 621 (7th Cir. 1949); *Dwight & Lloyd Sintering Co. v. American Ore Rec. Co.*, 263 Fed. 315 (2d Cir. 1920), cert. denied, 252 U. S. 582; *Pollard v. Bailey*, 20 Wall 520, 525-526 (1874); *United States v. Boisdore*, 8 How. 113, 122 (1850).

To construe subdivision 3 in the manner contended for by the Commissioner is, in effect, to ascribe to him a purpose to require a taxpayer to indulge in the idle and wasteful ceremony of filing a statement of an election the existence of which he steadfastly refused (105) to recognize. It would be rationally offensive to make provision for the time and manner of the filing of a statement of [47a] election by one in whom, it is asserted, the right to make an election does not reside, and to whom the right to make the election is denied. The Regulations are to be interpreted in the light of the position the Commissioner openly maintained and not on the basis of the unwarranted assumption that he was attempting to arrogate to himself, in the guise of interpretative regulations, the power to vitiate the statute. It is no answer that the statute was ultimately construed as granting to taxpayers generally the right to elect to use LIFO; for the regulations are to be construed for the purposes of this case as of March 10, 1943, unaided by wisdom acquired after the decision in *Hutzler*. Thus, it is inescapable that the purview of the original LIFO regulations did not embrace users of the retail method, not only in subdivision 2 thereof, but in subdivision 3 as well.

The failure of the Commissioner to prescribe in his regulations the time and manner of making the elections by taxpayers to whom the elective method was not available under the Regulations until after Macy's tax returns for fiscal 1942 had been filed, cannot operate to deprive Macy of the election available to it by statute. (106) *Cf. J. W. & A. P. Howard Co.*, 15 B. T. A. 1096 (1929); *Peck & Hills Furniture Co.*, 16 B. T. A. 1008 (1929). Within a reasonable time after issuance of the amended regulations adapting the retail inventory requirements of the

regulations to the elective inventory principle of section 22(d) of the Code as enunciated in *Hutzler*. Macy filed the appropriate statement of its election to adopt LIFO and had performed every act on its part to be performed to qualify for use of the elective method in computing its tax liabilities for fiscal 1942.

Kaufman & Baer Company v. *United States*, 137 F. [48a] Supp. 725 (Ct. Claims 1956) cert. denied 352 U. S. 835 is urged as authority to the contrary. In that case plaintiff filed Form 970 three weeks after the March 10, 1943 date set out in § 19.22 (d)-3. Within a month thereafter it wrote to the Commissioner with reference to the notice of election and the refund claim predicated thereon, stating in part:

> "Accordingly, we wish to advise you that we desire to withdraw this claim for refund and also to withdraw, or cancel, our application for a change in our inventory method."

The Commissioner in his reply advised that the case had been forwarded to the Agent in Charge and that it would be further advised by that official. The claim was thereafter disallowed, although it "was not really considered (107) in fact" (137 F. Supp. at p. 728), apparently because it had been withdrawn. In the subsequent suit for recovery of the claimed refund the defendant contended that the Court lacked jurisdiction since plaintiff had withdrawn its election and claim for refund. To this plaintiff countered "that the attempted withdrawal of its claim for refund was conditional on the Commissioner's allowance of the withdrawal or cancellation of its application to change its inventory method to LIFO, and that the Commissioner did not write it approving its withdrawal." (137 F. Supp. at p. 729) No reason suggests itself to the Court why, under

the circumstances in that case, disallowance of plaintiff's claim without consideration upon the merits, and the interposition of the defense that the notice of election and claim for refund had been withdrawn are less than approval by the Commissioner of withdrawal of both the claim and notice of election. [49a] Surely if the sole ground of the decision were derived from the Commissioner's aforementioned contentions, he would not have been heard to, and neither can he now validly contend that he had not acquiesced in such withdrawal. The claim for refund having been withdrawn, whether the notice of election had or had not been duly filed could not affect the result. Upon this view, the observations in *Kaufman & Baer* on the (108) timeliness of the filing of the notice of election do not, with due deference, rise above the level of *obiter dicta*.

The defendant's brief argues that administrative regulations in harmony with the statute under which they were issued are to be upheld. At issue is not whether subdivision 3 is to be upheld but rather whether it is to be expanded to encompass a class of taxpayers clearly not envisaged when it was promulgated. That the Commissioner could not by his regulations alter or amend the statute [*Norrell* v. *Jones*, 106 U. S. 466 (1882)], and that he erred in his interpretation of the scope and applicability of the statute to users of the retail method cannot be availed of to read into any part of his regulations a meaning which would include within the words "the taxpayer", as used in subdivision 3, a class consistently proclaimed by him to be excluded from the identical words in the immediately preceding subdivision of the same section.

Extended argument in defendant's brief relating to Macy's intent in 1942 to adopt statutory LIFO ends with the statement that it is not material. The affidavit in sup-

port of defendant's cross motion for summary judgment, via incorporation by reference, consists wholly of a letter dated May 18, 1954 from the Acting Commissioner of Internal Revenue to the District Director Internal Revenue Upper Manhattan, N. Y., commenting at length (109) [50a] upon the same "immaterial" matter. Exploring for Macy's intent would be useful if discovery that its failure to file Form 970 "was due to the Bureau's position of non-recognition of the right"[28] to use the LIFO method for Federal Income Tax purposes would prompt the Commissioner to reverse his reversal of his predecessor. No such suggestion is contained in the briefs; and, indeed, the position taken by the Commissioner in *Kaufman & Baer Company* v. *United States*; supra, would point to the contrary. Absent an applicable regulation fixing the time and manner for filing a statement of election no inferences may be drawn from the non-filing. Neither may an unfavorable inference as to Macy's intent be drawn from its support of the proposal put forth in 1942 by Randolph E. Paul, then tax advisor to the Secretary of the Treasury, which if enacted into law would have afforded "many taxpayers—unable to use the last-in first-out method, particularly taxpayers whose inventory consists of a large number of different products rather than a few homogeneous products",[29] substantially all the advantages of the LIFO method. Macy together with other retailers sought the safeguard against inclusion of book inventory profit in taxable income available to taxpayers who were (110) able to use the LIFO method. Confronted with opposition from all quarters it joined in recommendations for remedial legislation. That those recommendations, made before acquiescence by the Commissioner

[28] See note (23), supra.
[29] See note (11), supra.

in the determination that his construction of the statute was erroneous, differed in part from the then regulations and the statute as ultimately construed does not warrant the conclusion that given the election between statutory [51a] LIFO without the recommended change or no LIFO at all the choice would have been the latter. Rejection cannot be inferred from the failure to choose between nonexistent alternatives. *Cf. Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766 (D. C. Cir. 1934); *Belknap* v. *United States*, 55 F. Supp. 90 (D. C. W. D. Kentucky 1944).

For its failure to join with *Hutzler* and others in contesting the validity of the Commissioner's interpretation of the statute, the defendant would visit upon Macy a denial of the Congressional grant of the right to adopt the elective method for all years antecedent to the decision in that case. The pervasive theme of the defendant's brief is that an "* * * erroneous interpretation of the act by the Treasury Department [does] not estop the government from asserting the tax, even though the taxpayer may have been misled by such interpretation." [citing *Langstaff* v. *Lucas*, 9 F. 2d 691 (D. C. W. D. Kentucky 1925); (111) aff'd 13 F. 2d 1022 (6th Cir. 1926), cert. denied 273 U. S. 721 (1926)]. This position mistakenly equates the consequences flowing from a taxpayer's reliance upon the Commissioner's erroneous construction of the law with those resulting from the Commissioner's omission or neglect to issue a regulation, i. e., his failure to issue an applicable regulation fixing the time for filing the statement of election by a taxpayer employing the retail method. The Commissioner's mistake was twofold: first, as reflected in sec. 19.22(d)-2 in not recognizing the right of users of the retail method to adopt LIFO; and second, in not prescribing the time and manner for such taxpayers

to file a statement of election to use LIFO. With respect to his first mistake the Commissioner, recognizing that "[e]ven tax administration does not as a matter of principle preclude considerations of fairness", *Angelus* [52a] *Milling Co.* v. *Commissioner*, 325 U. S. 293, 297 (1944), amended the LIFO regulations retroactively to all taxable years beginning after December 31, 1938. These amended regulations were issued in consonance with the suggestion in *Hutzler* that "[t]he adoption of appropriate details to accomplish the general purpose of applying the LIFO method to retail merchants could well be the subject of an administrative regulation." (8 T. C. at p. 32). (112)

Reference is not made in the amended regulations to sec. 19.22 (d)-3. However, whether the amended regulations, despite the lack of express reference to sec. 19.22 (d)-3, are to be construed as also amending that sub-section or as leaving it unchanged, the result vis-a-vis Macy is the same. For the Commissioner's error in failing to issue an applicable regulation fixing the time for filing a statement of election, Macy cannot be positioned as if an applicable regulation had been issued and it defaulted in complying therewith. Its non-compliance with an inapplicable regulation cannot be availed of as a time bar. That the Commissioner omitted to issue an applicable regulation because he erroneously interpreted the statute and that Hutzler and others successfully challenged such interpretation does not supply the omission.

The cases cited by the defendant are inapposite, and the effort to analogize them with the case at bar highlights its oversight of the problem posed in this case. In *Radiant Glass Co.* v. *Burnet*, 54 F. 2d 718 (D. C. Cir. 1931) the facts were these. The taxpayer filed its corporate income

tax return for 1922 showing no tax to be due. An audit of the return made in 1926 disclosed a number of errors as a result of which a tax deficiency, was [53a] assessed. Thereupon, a petition was filed praying that the taxable income and income tax of the taxpayer and an affiliated corporation (113) be treated and computed as a consolidation under the Revenue Act of 1921. For the year 1921 affiliated corporations were required to file consolidation returns, but for the year under review such corporations were permitted to file consolidated or separate returns at their election. In 1921 the Commissioner had ruled that taxpayer and the other corporation were not affiliated in law and, accordingly, should not file a consolidated return. Separate returns for that year were thereupon filed. The relations of the companies remaining the same, separate returns were again filed for 1922. In 1926 the Commissioner reversed his earlier ruling and permitted an amendment of the return for 1921, to wit, the year when a consolidated return was obligatory, but refused to permit an amendment of the return for 1922 when such corporations were entitled to file either separate or consolidated returns at their election. In affirming a denial of the prayer, the court held that (i) when the taxpayer came to make out and file its return for 1922 it was entitled, if affiliated with another corporation, to file either a separate or consolidated return; (ii) the ruling of the Commissioner with respect to the prior year did not prevent or impair the free exercise of that right; and (iii) the right of choice or election to file a separate or consolidated return is exercised by filing the return.
(114)

The controlling facts in *Safety Electric Products Co. Inc.* v. *Helvering*, 70 F. 2d 439 (9th Cir. 1934), are almost identical. The Revenue Act of 1926 permitted affiliated corporations to file a consolidated return or separate [54a]

returns at their election. In 1926 petitioner was affiliated with two other corporations and was entitled to file a consolidated return for the group if it elected to do so. However, a consolidated return for only two of the companies was filed—the third having filed a separate return because the Treasury Department had objected to the filing by said third company as an affiliate for the preceding year. In 1929 a consolidated return of all three companies for the year 1926 was filed. Relying upon, and quoting at length from *Radiant Glass Co.* v. *Burnet*, supra, the court held that the filing of the separate return by the third company was an election, and having made its election or choice it was bound thereby and could not afterwards change.

Lamb v. *Smith*, 183 F. 2d 938 (3rd Cir. 1950), presented two issues: whether a family partnership was to be given recognition for tax purposes; and if so, whether the husband and wife were to be permitted to file separate returns for a year in which they had previously filed a joint return. It was contended that the joint return was filed as a result of the Commissioner's refusal to (115) recognize the wife's interest in the partnership. The first issue was resolved in favor of, and the second adversely to, the taxpayers. The Commissioner's refusal to recognize the partnership, observed the court, did not prevent the taxpayers from filing separate returns, and having freely elected to file a joint return they were bound by their knowledgeable choice.

It is to be observed that in each of the three cases relied on by the government the taxpayer was given a choice by statute to file one sort of return or another and after exercising the election sought to be relieved therefrom. In each instance, too, a claim was asserted [55a] that the original choice was influenced by an erroneous determination by the Commissioner. In none of the cases, however, did the error

of the Commissioner prevent or impair the free exercise of the statutory option. There was no provision in the statutes involved in these cases for filing a notice of election to use one type of return or another separate and apart from the return itself. The election was exercisable in each instance by filing the return of the taxpayer's choice. In the case at bar on the other hand, the election to adopt LIFO was to be effectuated in part by filing a separate application at such time and in such manner as the Commissioner prescribed. The failure of the Commissioner so to prescribe with respect to users of the retail method prevented and impaired the exercise of the (116) election by Macy. Under these circumstances to deny relief to Macy would be to permit the Commissioner to benefit by his own nonfeasance.

The recommendation of the Commissioner in office in 1951 that Macy's "right to use LIFO beginning with the taxable year ended January 31, 1942, be recognized" is just and well-advised.

Accordingly, plaintiff's motion for summary judgment is granted.

Dated: January 31, 1957.

ALEXANDER BICKS
United States District Judge

[3a] Stipulation of Facts

(122)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

CIVIL No. 96-236

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO. and THE LASALLE & KOCH COMPANY,

Plaintiffs,

—against—

UNITED STATES OF AMERICA,

Defendant.

IT IS HEREBY STIPULATED that the following facts shall be taken as true for the purpose of the above-entitled action for refund, provided, however, that this stipulation shall be without prejudice to the right of any party to said action to introduce other and further evidence not inconsistent with the facts hereinafter stipulated to be true.

1. The action is brought to recover an internal revenue tax as hereinafter set forth. Such action is brought pursuant to, and the jurisdiction of this Court is founded upon, Title 28, United States Code, Sections 1340 and 1346(a) (1), as amended by Public Law 559, 83rd Con-

[4a] gress, (123) July 30, 1954 (68 Stat. 589). (Complaint, par. 1; admitted in answer.)

2. Plaintiff R. H. Macy & Co., Inc. (hereinafter called "Macy") is, and at all times hereinafter mentioned was, a corporation organized and existing under and by virtue of the laws of the State of New York, engaged in the operation of retail department stores, with its principal place of business at Broadway and 34th Street, New York 1, N. Y., and its principal office at 151 West 34th Street, New York 1, N. Y. (Complaint, par. 2; admitted in answer.)

3. At all times hereinafter mentioned prior to January 31, 1948, Macy was the sole stockholder of plaintiff L. Bamberger & Co. (hereinafter called "Bamberger"), a New Jersey corporation, plaintiff Davison-Paxon Co. (hereinafter called "Davison-Paxon"), a Georgia corporation, and plaintiff The LaSalle & Koch Company (hereinafter called "LaSalle & Koch"), an Ohio corporation. Bamberger, Davison-Paxon and LaSalle & Koch (sometimes hereinafter referred to as "subsidiaries") were engaged in the ownership and operation of retail department stores prior to January 31, 1948.

4. For many years prior to the fiscal year ended January 31, 1942, Macy and its subsidiaries employed the (124) retail method of inventory valuation (hereinafter sometimes called the "retail method"). The retail method then was, and it still is, an accepted method of inventory valuation under the Regulations promulgated by the Commissioner of Internal Revenue (hereinafter sometimes called the "Commissioner"). Under the retail method, as

[5a] used by large department stores, inventory records are maintained by departments in terms of selling price dollar values rather than in terms of specific items of merchandise. (Complaint, par. 4; admitted in answer).

5. The FIFO method, used by Macy and its subsidiaries prior to the fiscal year ended January 31, 1942, assumes that an article of merchandise "first-in", *i.e.*, the article purchased earliest, was the first one sold, and that the articles left in the inventory at the end of the year were the last articles purchased. To the extent that inventories are stated at cost, the cost of the items in the inventory at the end of the year would be based on the cost of the last articles purchased.

The LIFO method of inventory assumes that an article of merchandise "last-in", *i.e.*, the article purchased last, was the first sold and that the articles left in the inventory at the end of the year were the first articles purchased. To the extent that inventories are stated at cost, the cost of (125) the items in the inventory at the end of the year would be based on the cost of the first articles purchased.

In the case both of the FIFO and LIFO methods, the foregoing assumptions are made irrespective of the order in which the goods are actually sold.

The difference between FIFO and LIFO insofar as it relates to profits and taxable income is illustrated (a) in a period of rising prices and (b) in a period of falling prices as follows:

(a) During a period of rising prices, a retailer starts out with one shirt which cost him $2. He buys another

for $3. He sells one for $4. His clos- [6a] ing inventory and profits on a FIFO and LIFO basis will be as follows:

FIFO		LIFO	
Opening Inventory	$2.00	Opening Inventory	$2.00
Cost of Purchases	3.00	Cost of Purchases	3.00
Total	5.00	Total	5.00
Less Cost of Closing Inventory (last in)	3.00	Less Cost of Closing Inventory (first in)	2.00
Cost of Goods Sold	2.00	Cost of Goods Sold	3.00
Sales	$4.00	Sales	$4.00
Cost of Goods Sold	2.00	Cost of Goods Sold	3.00
Gross Margin	2.00	Gross Margin	1.00

(126)

On the FIFO basis, $1 of the $2 gross margin represents paper profit since the retailer must keep a stock of one shirt. On the LIFO basis, there is no paper profit because LIFO assumes that a retailer's basic inventory (one shirt in this example) is carried on the books at a stabilized value.

(b) During a period of falling prices, the difference between FIFO and LIFO is illustrated by the following example: Assume that in the following year, the retailer buys another shirt for $2 and sells one for $3 instead of $4. His inventory and [7a] profits on a

FIFO and LIFO basis for such second year will be as follows:

FIFO		LIFO	
Opening Inventory	$3.00	Opening Inventory	$2.00
Cost of Purchases	2.00	Cost of Purchases	2.00
Total	5.00	Total	4.00
Less Cost of Closing Inventory (last in)	2.00	Less Cost of Closing Inventory (first in)	2.00
Cost of Goods Sold	3.00	Cost of Goods Sold	2.00
Sales	$3.00	Sales	$3.00
Cost of Goods Sold	3.00	Cost of Goods Sold	2.00
Gross Margin	NONE	Gross Margin	1.00

(127)

In the first year in which a taxpayer changes from FIFO to LIFO, opening inventories are always the same under either basis, if stated at cost.

6. Under the retail method, the inventory of a particular department is determined, in substance, as follows:

(1) on the day physical inventory is taken, the retail price of all merchandise in stock is taken from the price tag or other price marking on the [8a] merchandise, and the aggregate dollar amount of the inventory, at retail prices, is determined;

(2) from vendors' invoices for the merchandise purchased, there is accumulated the cost shown thereon and the amount calculated at retail prices (inserted thereon by the department manager) and, from that accumulation for the accounting period (including the opening inventory), there is determined the ratio* of the aggregate cost to the aggregate amount at retail, and

(3) the figure resulting from multiplying the aggregate dollar amount at retail in (1) above by the ratio as determined in (2) above is the inventory for such department.

For years prior to the fiscal year ended January 31, 1942, Macy and its subsidiaries used the foregoing method and in (128) common with other retail department stores using the retail inventory method, calculated the so-called mark-up factor by taking mark-ups, but not mark-downs, into account in the calculation described in (2) above. In general, the effect of such method is to obtain a basis for the inventories of approximate cost in a period of constant or rising prices and of approximate market in a period of falling prices. To the extent that prices run counter to the trend, there is to that extent a deviation from the general rule.

7. In 1942 and 1943 and continuously thereafter until 1948, the Commissioner and other representatives of the Treasury Department and the Bureau of Internal Revenue took the position that LIFO was not available [9a]

*The difference between this ratio and 100% is the mark-up factor.

to users of the retail method since such users determined their inventories in terms of dollar values rather than in terms of specific goods, with the result that the Commissioner and such other representatives maintained that the specification required by Section 22(d) of the Code* was lacking. Due to the multiplicity of items carried by retail department stores and the varying price ranges of those items, it is not practicable to account for the inventories of those stores on an item basis.

8. In 1942 Macy and other retailers, as well as representatives of the National Retail Dry Goods Association, (129) held conferences with various representatives of the Treasury Department and the Bureau of Internal Revenue in order, among other things, to urge those agencies to abandon the position maintained by them, as described in paragraph 7 above.

9. Notwithstanding the opposition of the Commissioner and other representatives of the Treasury Department as described in paragraph 7 above, some retail department stores filed Treasury Department Form 970 with their Federal income tax returns for fiscal years ended in 1942. While the parties have not been able to determine the exact number of such retail department stores, it is believed that the number may be about 70. A substantial number, if not all, of such retail department stores, including Hutzler Brothers Company, calculated the mark-up factor by taking mark-ups, but not mark-downs, into account, and they adjusted closing inventories to LIFO by an index of retail price changes that was not then or thereafter authorized or approved by the Treasury Department or the Bureau of Internal Revenue.

*"Code" references are to the Internal Revenue Code of 1939.

[10a] 10. The following is an extract from the minutes of meeting held by the Executive Committee of Macy's Board of Directors on March 20, 1942:

> "LIFO—a method of evaluating merchandise inventories (Last-in First-out) was discussed and it was decided to adopt this method for the purpose of determining the operating profit to be reflected in the Stockholders Annual Report for the year (130) 1941. However, with respect to the Federal Income Taxes, it was decided to ask for a sixty-day extension, and if need be for a second sixty-day extension, so that we would be able to study the new tax law before filing a final Federal Income Tax return."

11. The following is an extract from the minutes of a meeting held by the Macy Board of Directors on March 25, 1942:

> "The Treasurer reported that, after full consideration of the matter, the Executive Committee at its meeting on March 20, 1942, had decided to recommend that the so-called 'LIFO' (Last-In-First-Out) method of valuing inventories of the Corporation and its subsidiaries be adopted for purposes of the Annual Report to stockholders for the fiscal year ended January 31, 1942; and that decision as to the method of valuing inventories for tax purposes for that year be deferred pending further study of the matter in the light of possible amendments to the tax laws relative thereto.
>
> "After due discussion and deliberation, and on motion duly made and seconded, the following resolution was unanimously adopted:
>
> [11a] "RESOLVED, that the Board of Directors of this Corporation does hereby authorize that the so-called 'LIFO' (Last-In-First-Out) method

of valuing inventories of this Corporation and its subsidiaries be adopted for purposes of the Annual Report to stockholders for the fiscal year ended January 31, 1942; and does hereby direct that decision as to the method of valuing such inventories for tax purposes for that year be and the same hereby is deferred pending further study of the matter in the light of the existing tax laws and possible amendments which may be made thereto and applicable to that year, prior to the filing of the tax returns for said fiscal year; and that the principal officers of this Corporation, and each of them, be and they hereby are authorized to request and obtain such extensions of time for the filing of tax returns for that year and to take any and all such other action in connection therewith as they may deem necessary and proper."

(131)

12. Attached hereto and made part hereof as Exhibit 1 is a true copy of the Annual Report of Macy and its subsidiaries for the fiscal year ended January 31, 1942. The opening inventories for said fiscal year were arrived at for purposes of said Annual Report by use of the retail method, as described in paragraphs 4, 5 and 6 above. The LIFO adjustments in connection with closing inventories were based upon an index of retail price changes prepared by the National Industrial Conference Board.

[12a] 13. Attached hereto and made part hereof as Exhibit 2 is a true copy of the Macy Prospectus dated May 25, 1942, relating to a $12,000,000 issue of Ten-Year 2½% Sinking Fund Debentures.

14. The taxes shown on the tentative United States income and declared value excess profits tax returns of

Macy and its subsidiaries for the fiscal year ended January 31, 1942, which were filed in April 1942, were computed according to the retail method described in paragraphs 4, 5 and 6 above and by making the LIFO adjustments in connection with closing inventories based upon an index of retail price changes prepared by the National Industrial Conference Board. The regular books of account of Macy and its subsidiaries for the fiscal year ended January 31, 1942 were kept on the same basis.

(132)

15. Attached hereto and made part hereof as Exhibit 3 is a copy of a statement made on June 15, 1942, by Randolph E. Paul, tax adviser to the Secretary of the Treasury, before the Ways and Means Committee of the House of Representatives with respect to the proposed amendment of the Internal Revenue Code regarding inventory reserves.

16. Attached hereto and made part hereof as Exhibits 4 and 5 are copies of the following letters:

(a) letter dated June 30, 1942, to Macy from Leon Lauterstein, Macy's then general counsel. The reference to Mr. Friedman in this letter is a reference to Mr. J. P. Friedman of Touche, Niven & Co., Macy's auditors.

[13a] (b) letter to Macy dated July 3, 1942, from Mr. Lauterstein.

On July 3, 1942, Macy's Executive Committee authorized Touche, Niven & Co. to file Federal income tax returns for the fiscal year ended January 31, 1942, in the manner

recommended by Mr. Lauterstein's aforesaid letters of June 30 and July 3, 1942.

17. Attached hereto and made part hereof as Exhibit 6 is a copy of the federal income and declared value excess profits tax return of Macy for the fiscal year ended (133) January 31, 1942, which was filed on July 15, 1942. There have been omitted from said Exhibit certain lengthy schedules which the parties do not deem to be pertinent. The opening and closing inventories shown in Schedule A thereof were computed in the manner described in paragraphs 12 and 14 above, and were in the same amounts as were included in the Annual Report of Macy and its subsidiaries for that year. Cost of purchases was shown on Macy's books as $68,850,906.75, which was the actual cost of purchases; whereas cost of purchases was shown in Schedule A of the return as $67,233,491.75. The difference between these two figures, amounting to $1,617,415.00 (shown as Item 7 (j) of Schedule M of the return), represents the amount of the adjustment which was necessary in order to state cost of goods sold on the return on the FIFO basis. Substantially similar methods were used in the returns of Bamberger, Davison-Paxon and LaSalle & Koch for the fiscal year ended January 31, 1942. Those returns for that fiscal year were filed on or about July 15, 1942.

18. The minutes of meeting of the Executive Com- [14a] mittee of the Macy Board of Directors held on August 21, 1942, state in part as follows:

"The Secretary reported that as authorized in the minutes of July 3, 1942, the Federal Corporate Tax Return, had been filed on the basis of valuing inven-

tories under the retail method, as provided in the present law and not under the LIFO method."

19. Until October 21, 1942, the date of approval of the Revenue Act of 1942, Section 22(d)(B) of the Code and (.134) Treasury Regulations 101, as amended by T. D. 4959 (1940-1 Cum. Bull. 22), approved December 28, 1939, limited the use of LIFO to taxpayers who could establish as a fact that they had not used any procedure other than the procedure set forth in Section 22(d)(1)(B) and (C) of the Code in inventorying goods, for the purpose of reports to stockholders or creditors, for any period during the first taxable year for which the LIFO method was to be used. As Macy and its subsidiaries had issued a consolidated semi-annual report to stockholders on a basis other than the basis set forth in said Section 22(d)(1)(B) and (C) for the six months period ended August 2, 1941, they were ineligible to use LIFO for income tax purposes prior to October 21, 1942.

20. Section 118 of the Revenue Act of 1942 removed the prohibition against the adoption of LIFO for a year during which interim reports had been issued on a basis other than the basis set forth in the preceding paragraph. This change was retroactive to taxable years beginning after December 31, 1938. It retained the requirement that annual reports be made on said basis.

[15a] 21. The final United States corporation income and declared value excess profits tax returns of Macy and its subsidiaries for the fiscal year ended January 31, 1942, were timely filed with, and the tax shown thereon was on

or about the statutory instalment dates timely paid to, the (135) Collectors of Internal Revenue as follows:

Company	Collector's Office Where Returns Filed and Tax Paid	Amount of Tax Paid
(a) Macy	3d District New York, N. Y.	$1,212,493.92
(b) Bamberger	5th District Newark, N. J.	586,444.35
(c) Davison-Paxon	Atlanta, Ga.	176,106.67
(d) LaSalle & Koch	Toledo, Ohio	188,518.99

Additional amounts of such tax for said fiscal year were assessed and, on February 6, 1951, were paid to the Collector of Internal Revenue for the Third District of New York as follows:

Company	Amount of Tax Paid
(e) Bamberger	$14,143.06
(f) Davison-Paxon	591.02

(Complaint, par. 10; admitted in answer.)

The United States corporation income and declared value excess profits tax returns of Macy and its subsidiaries for the fiscal year ended January 31, 1942, were prepared and filed on the accrual basis of accounting, the method of accounting regularly maintained on the books of account of Macy and its subsidiaries.

[16a] (136)

22. Attached hereto and made part hereof as Exhibit 7 is a copy of pages S-32 and S-33 of the explanatory notes to the financial statement comprising Item 8 of

Macy's interim report on Form 10-K dated November 25, 1942, to the Securities and Exchange Commission for Macy's 26-week fiscal period ended August 1, 1942.

23. As of August 1, 1942, Macy and its subsidiaries changed their fiscal year for book purposes so as to end on the Saturday nearest July 31, although their fiscal year for Federal tax purposes continued to end on January 31. Attached hereto and made part hereof as Exhibit 8 is the audited report of Macy and its subsidiaries for the six-months period ended August 1, 1942.

24. Attached hereto and made part hereof as Exhibit 9 is a copy of a letter dated December 17, 1942 from the National Retail Dry Goods Association to its members enclosing a memorandum dated December 17, 1942 entitled "The Lifo Situation Up-to-Date."

25. Attached hereto and made part hereof as Exhibits 10 and 11 are a copy of the Annual Report to stockholders of Macy and its subsidiaries for the fiscal years ended July 31, 1943 and July 31, 1948, respectively.

26. On February 5, 1944, in pursuance of the position maintained by the Commissioner and other representatives of the Treasury Department, as described in paragraph (137) 7 above, the Bureau of Internal Revenue issued a deficiency notice to Hutzler Brothers Company, a Baltimore department store (one of the approximately 70 retailers referred to in paragraph 9 above) that filed Treasury Department Form 970 on the LIFO basis with its Federal income tax return for the fiscal year ended [17a] January 31, 1942. That deficiency notice disapproved the adoption and use by Hutzler Brothers Company of LIFO by employ-

ment of retail price index figures in connection with the retail inventory method for the taxable year of said Company ended January 31, 1942. In 1947 The Tax Court of the United States decided (8 T. C. 14) in favor of the adoption and use of LIFO by Hutzler Brothers Company by employment of retail price index figures in connection with the retail inventory method for that company's taxable year ended January 31, 1942. Subsequently to the Tax Court's decision in the *Hutzler* case, the Commissioner published Mimeograph 6244, 1948-1 C. B. 21 (March 9, 1948). As a result of the decision in the *Hutzler* case, the LIFO regulations were amended. See Treasury Decision 5605, 1948-1 C.B. 16, March 4, 1948. The amendment was made retroactive to all taxable years beginning after December 31, 1938.

27. On January 31, 1948, Bamberger, Davison-Paxon and LaSalle & Koch were completely liquidated, and their property and assets, including the claims for refund of tax alleged in the complaint herein, were distributed (138) to Macy in complete cancelation and redemption of all of its stock in each of said subsidiaries. Although each of the aforesaid subsidiaries was completely liquidated on January 31, 1948, the corporate existence of each of said subsidiaries has continued to date, and each of said subsidiaries is, under the law of its state of incorporation, capable of suing and being sued in its own name.

28. Claims (on Treasury Department Form 843) for refund of income tax and declared value excess profits tax for the fiscal year ended January 31, 1942, were timely filed with the Collector of Internal Revenue for the Third District of New York on October 18, 1948 on behalf [18a] of Macy and on October 15, 1948, on behalf of Macy's sub-

sidiaries. Said claims were based upon the contention that Macy and its subsidiaries had validly elected to use the LIFO method of inventory valuation for said fiscal year pursuant to the provisions of Section 22(d) (1)-(5) of the Code. Said claims for refund are in the following amounts:

Company	Amount
(a) Macy	$433,334.04
(b) Bamberger	141,913.73
(c) Davison-Paxon	37,502.38
(d) LaSalle & Koch	32,484.62
Total	$645,234.77

(139)

Attached hereto and made part hereof as Exhibit 12 is a folder containing a copy of said claims for refund and the exhibits thereto. Attached to each of said claims for refund is Treasury Department Form 970 executed by officers of Macy and its subsidiaries duly authorized to execute such form. Neither Macy nor its subsidiaries had filed such Form 970 with their returns for the fiscal year ended January 31, 1942 or prior to the filing of said claims for refund.

29. Further claims (on Treasury Department Form 843) for refund of income tax and declared value excess profits tax for the fiscal year ended January 31, 1942, were timely filed on behalf of Macy and its subsidiaries with the Collector of Internal Revenue for the Third District of New York. The ground of said refund claims is [19a] that Macy and said subsidiaries were entitled, in valuing inventories for said fiscal year, to take into account the

involuntary liquidation and replacement provisions contained in Section 22(d)(6) of the Code. Said claims for refund were filed on the following dates and in the following amounts:

(140)

Company	Amount	Date Refund Claim Filed
(a) Macy	$32,085.80	October 18, 1948
(b) Bamberger	13,141.87	October 15, 1948
(c) Davison-Paxon	2,599.34	October 15, 1948
(d) LaSalle & Koch	2,363.40	October 15, 1948
Total	$50,190.41	

Amended claims for refund on behalf of Macy and its subsidiaries on the aforesaid ground of involuntary liquidation and replacement were timely filed as follows:

(i) *First amended claims filed as follows:*

Company	Collector of Internal Revenue	Amount	Date Refund Claim Filed
(e) Macy	3rd District, New York, N. Y.	$40,810.04	Oct. 8, 1951
(f) Bamberger	5th District, Newark, N. J.	15,214.32	Oct. 9, 1951
(g) Davison-Paxon	Atlanta, Ga.	5,080.00	Oct. 10, 1951
(h) LaSalle & Koch	Toledo, Ohio	2,552.71	Oct. 10, 1951
	Total	$84,537.07	

[20a] (141)

(ii) *Second amended claims filed on or about November 3, 1952:*

(i) Macy	3d District New York, N. Y.	$55,419.25
(j) Bamberger	5th District, Newark, N. J.	17,050.52
(k) Davison-Paxon	Atlanta, Ga.	7,073.12
(l) LaSalle & Koch	Toledo, Ohio	2,475.00
	Total	$82,017.89

(Complaint, par. 18; admitted in answer.)

Attached hereto and made part hereof as Exhibit 13 is a folder containing copies of the claims for refund filed by plaintiffs on the ground of involuntary liquidation and replacement of inventory for the fiscal year ended January 31, 1942. Attached to said Exhibit 13 are the first amended and second amended claims for refund as alleged in paragraph 18 of the complaint herein.

30. Attached hereto and made part hereof as Exhibit 14 is a copy of a letter dated January 31, 1951 from then Deputy Commissioner of Internal Revenue E. I. McLarney to the Internal Revenue Agent in Charge, Upper New York Division, New York, N. Y. The foregoing letter was not communicated to Macy through any official channel of the Treasury Department. Macy did, however, receive a letter under even date signed by Deputy Commissioner McLarney, a copy of which (142) is attached hereto and made part hereof as Exhibit 15. Said [21a] letter was in response to Macy's January 15, 1951 application to the Commissioner for a ruling relating to

adoption of the LIFO method. A copy of said January 15, 1951 letter from Macy to the Commissioner is attached hereto and made part hereof as Exhibit 16.

31. Macy for itself and its subsidiaries requested of the Commissioner of Internal Revenue on August 8, 1951, that, if the election of involuntary liquidation in the aforesaid claims and amended claims for refund, as alleged in paragraph 18 of the complaint herein, was not regarded as timely, an extension of time should be granted within which such election could be made. On August 17, 1951, then Commissioner of Internal Revenue John B. Dunlap granted such request for an extension of time to September 30, 1951, within which to make such election (Complaint, par. 20; admitted in answer). Statements of election pursuant to such extension of time were filed by Macy for itself and its subsidiaries on or about September 25, 1951. Copies of such statements of election are attached hereto and made part hereof as Exhibit 17. Attached hereto and made part hereof as Exhibits 18 and 19, respectively, are a letter dated August 8, 1951 from Macy to the Commissioner and a letter dated August 17, 1951 in reply from the Commissioner to Macy. Also attached hereto (143) and made part hereof as Exhibits 20 and 21, respectively, are Macy's August 20, 1951 telegram to the Commissioner and the latter's August 21, 1951 telegram in reply.

32. Attached hereto and made part hereof as Exhibits 22, 23, 24 and 25, respectively, are copies of separate letters sent to Macy, Bamberger, Davison-Paxon and LaSalle & Koch under date of October 31, 1951, by the [22a] Internal Revenue Agent in Charge, Upper New York

Division, New York, New York, enclosing in each case a Revenue Agent's Report dated July 2, 1951, relating primarily to the fiscal year ended January 31, 1942. Such Revenue Agent's Reports are included in the attached Exhibits. The aforesaid separate letters were sent by the Internal Revenue Agent in Charge to Macy and its subsidiaries pursuant to the recommendation contained in Deputy Commissioner McLarney's aforesaid January 31, 1951 letter to the Internal Revenue Agent in Charge.

33. Despite the aforesaid letters and the aforesaid Revenue Agent's Reports dated July 2, 1951, the proposed overassessments as set forth in such Revenue Agent's Reports were not certified for payment, and the amounts of said proposed overassessments were not paid to Macy or any of its subsidiaries by credit or otherwise. (Complaint, par. 22; admitted in answer.)

34. A substantial number, if not all, of the (144) retail department stores mentioned in paragraph 9 above, including Hutzler Brothers Company, Federated Department Stores, Inc., and Allied Stores Corporation, have been allowed by the Commissioner of Internal Revenue to use the LIFO method beginning with their fiscal years ended in 1942, despite the fact that the Treasury Department Form 970 that those retail department stores filed with their Federal income tax returns for their fiscal years ended in 1942, used an index of retail price changes that was not authorized or approved by the Treasury Department or the Bureau of Internal Revenue and despite the further fact that in calculating the so-called mark-up factor, mark-ups but not mark-downs were taken into account. After the LIFO regulations were amended [23a] in March 1948, those retail department stores did not file any new Treasury Department Forms 970 but were per-

mitted by the amended LIFO Regulations referred to in paragraph 26 above to file new schedules for fiscal 1942 on which they took into account mark-downs as well as mark-ups and on which they used indices of retail price changes that were then authorized by the Bureau of Internal Revenue. When Macy and its subsidiaries in October 1948 filed their claims for refund (paragraphs 28 and 29 above), the amounts of the claimed refunds were computed in accordance with the LIFO Regulations as amended in March 1948, *viz.*, by taking into account mark- (145) downs as well as mark-ups in the computation of opening and closing inventories, and by applying to closing inventories the Bureau of Labor Statistics department store index of retail price changes, an index that was then authorized by the aforesaid Regulations.

35. Attached hereto and made part hereof as Exhibit 26 is a folder containing copies of separate letters addressed to Macy and its subsidiaries on or about August 27, 1954 by Harold B. A'Hearn, District Director of Internal Revenue, Upper Manhattan, New York, enclosing statements proposing to disallow the claims for refund and the first amended and second amended claims for refund as alleged in paragraphs 17 and 18 of the complaint herein.

36. Attached hereto and made part hereof as Exhibit 27 are copies of the statutory notices of disallowance sent to plaintiffs Macy and Bamberger by the Commissioner of Internal Revenue by registered mail on November 24, 1954 in respect of the fiscal year ended January 31, 1942.

[24a] 37. The parties hereto agree that if the Court finds that there has been a timely election of LIFO by plain-

tiffs for the fiscal year ended January 31, 1942 for tax purposes, then there has also been for that fiscal year a timely election by plaintiffs of the involuntary liquidation and replacement provisions of Section 22(d)(6) (146) of the Code. In the event it is held that Macy and its subsidiaries are entitled to refunds of tax as alleged in the complaint herein, it is agreed that the amount of such refunds will be computed subsequent to the decision of this Court on the merits. It is also agreed that if the Court enters its decision for plaintiffs, interest on the amount of the judgment is allowable as provided by law. It is further agreed that in the event it is held that plaintiffs are entitled to refunds of tax, as aforesaid, judgment for the entire amounts of such refunds may be entered in favor of Macy on its own behalf and as successor to Bamberger, Davison-Paxon and LaSalle & Koch.

July , 1955.

CRAVATH, SWAINE & MOORE,

by .....
a member of the firm,
15 Broad Street,
New York 5, N. Y.
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Attorney for Defendant.

STATUTES, REGULATIONS AND RULINGS

Statutes

INTERNAL REVENUE CODE OF 1939:

SEC. 22. GROSS INCOME.

(c) *Inventories.* Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) (1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c)) in inventorying goods specified in the application required under paragraph (2):

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) Only in inventorying goods (required under subsection (c) to be inventoried) specified in an appli-

cation to use such method filed at such time and in such manner as the Commissioner may prescribe; and

(B) Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that specified in subparagraphs (B) and (C) of paragraph (1) in inventorying [(to ascertain income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries) such goods for any period beginning with or during the first taxable year for which the method described in paragraph (1) is to be used.] *such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in paragraph (1) is to be used, for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or to beneficiaries, or (ii) for credit purposes.**

(3) The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(4) In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.

(5) If a taxpayer, having complied with paragraph (2), uses the method described in paragraph (1) for any taxable year, then such method shall be used in all subsequent taxable years unless—

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*Material in brackets deleted and material in italics added by Revenue Act of 1942, Section 118(a), 56 Stat. 814.

(A) With the approval of the Commissioner a change to a different method is authorized; or

(B) The Commissioner determines that the taxpayer has used for [any period beginning with or during] any *such* subsequent taxable year some procedure other than that specified in subparagraph (B) of paragraph (1) in inventorying [(for ascertaining income, profit, or, loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries)] the goods specified in the application *to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or beneficiaries, or (ii) for credit purposes;* and requires a change to a method different from that prescribed in paragraph (1) beginning with such subsequent taxable year or any taxable year thereafter.

In either of the above cases, the change to, and the use of, the different method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.*

Regulations

REGULATIONS 103:

SEC. 19.22(c)–8. *Inventories of retail merchants.*—Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns

*Material in brackets deleted and material in italics added by Revenue Act of 1942, Section 18(b), 56 Stat. 814.

upon that basis, provided (1) that the use of such method is designated upon the return, (2) that accurate accounts are kept, and (3) that such method is consistently adhered to unless a change is authorized by the Commissioner as provided in section 19.41–2. Under this method the total of the retail selling prices of the goods on hand at the end of the year in each department or of each class of goods is reduced to approximate cost by deducting therefrom an amount which bears the same ratio to such total as—

(*a*) the total of the retail selling prices of the goods included in the opening inventory plus the retail selling prices of the goods purchased during the year, with proper adjustment to such selling prices for all mark-ups and mark-downs,

less

(*b*) the cost of the goods included in the opening inventory plus the cost of the goods purchased during the year,

bears to (*a*).

This amount should represent as accurately as may be the amounts added to the cost price of the goods to cover selling and other expenses of doing business and for the margin of profit.

*For further adjustments to be made in the case of a retail merchant using the elective inventory method authorized by section 22(d), see section 19.22(d)-1.**

A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross profit should not use a percentage of

*Added by T. D. 5605, 1948-1 Cum. Bull. 16.

profit based upon an average of his entire business, but should compute and use in valuing his inventory the proper percentages for the respective departments or classes of goods.

A taxpayer (*other than one using the elective inventory method*)* who previously has determined inventories in accordance with the foregoing, except that, to obtain a basis of approximate cost or market, whichever is lower, the practice has been followed, consistently and uniformly, of adjusting the retail selling prices of the goods included in the opening inventory and purchased during the year for mark-ups but not for mark-downs, may continue such practice subject to the conditions herein prescribed. The adjustments must be bona fide and consistent and uniform. Where mark-downs are not included in the adjustments, mark-ups made to cancel or correct mark-downs shall not be included; and the mark-ups included must be reduced by the mark-downs made to cancel or correct such mark-ups.

In no event shall mark-downs not based on actual reduction of retail sales prices, such as mark-downs based on depreciation and obsolescence, be recognized in determining the retail selling prices of the goods on hand at the end of the year.

A taxpayer (*other than one using the elective inventory method*)* who previously has determined inventories without following the practice of eliminating mark-downs in making adjustments to retail selling prices, may adopt such practice, provided permission to do so is obtained in accordance with, and subject to the terms provided by, section 19.41-2. A taxpayer filing a first return of income may adopt such practice subject to approval by the Commissioner upon examination of the return.

*Added by T. D. 5605, 1948-1 Cum. Bull. 16.

*A taxpayer using the elective inventory method in conjunction with retail computations must adjust retail selling prices for mark-downs as well as mark-ups, in order that there may be reflected the approximate cost of the goods on hand at the end of the year, regardless of market values.**

SEC. 19.22(d)–1. *Inventories under elective method.*— Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22(c), and pursuant to the provisions of sections 19.22(c)–1 to 19.22(c)–8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22(d), as amended. Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

First, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year beginning after December 31, 1938.

If the elective inventory method is used by a taxpayer who regularly and consistently, in a manner similar to hedg-

*Added by T. D. 5605, 1948-1 Cum. Bull. 16.

ing on a futures market, matches purchases with sales, then firm purchase and sales contracts (i.e., those not legally subject to cancellation by either party) entered into at fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that this practice is regularly and consistently adhered to by the taxpayer and that, in the opinion of the Commissioner, income is clearly reflected thereby.

SEC. 19.22(d)-2. *Requirements incident to adoption and use of elective method.*—The adoption and use of the elective inventory method is, by section 22(d) and regulations thereunder, made subject to the following requirements:

(1) The taxpayer shall file an application to use such method specifying with particularity the goods to which it is to be applied;

(2) The inventory shall be taken at cost regardless of market values;

(3) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand[, such]. *The* actual cost of the aggregate [being] *shall be* determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year *with the exception that restoration shall be made with*

*respect to any write-down to market values resulting from the pricing of former inventories;**

(4) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices, at costs determined as follows:

(*a*) By reference to the actual cost of the goods most recently purchased or produced;

(*b*) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(*c*) By application of an average unit cost equal to the aggregate cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 22(d) as having been acquired all at the same time; or

(*d*) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the elective inventory method is used by the taxpayer;

Example (*1*): Suppose that the taxpayer adopts the elective inventory method for the taxable year 1939 with

*Material in brackets deleted and material in italics added by T. D. 5163, 1942-2 Cum. Bull. 80.

an opening inventory of 10 units at 10 cents per unit, that it makes 1939 purchases of 10 units as follows:

January	1 @ 11	=	11
April	2 @ 12	=	24
July	3 @ 13	=	39
October	4 @ 14	=	56
Totals:	10		130

and that it has a 1939 closing inventory of 15 units. This closing inventory, depending upon the taxpayer's method of valuing inventory increases, will be computed as follows:

(*a*) Most recent purchases—

10 @ 10		=	100
4 @ 14	(October)	=	56
1 @ 13	(July)	=	13
Totals: 15			169

or

(*b*) In order of acquisition—

10 @ 10		=	100
1 @ 11	(January)	=	11
2 @ 12	(April)	=	24
2 @ 13	(July)	=	26
Totals: 15			161

or

(*c*) At an annual average—

10 @ 10		=	100
5 @ 13	(130/10)	=	65
Totals: 15			165

Example (2): Suppose, in addition to the facts stated in example (1), that there is a 1940 closing inventory of 13 units. This closing inventory, being determined wholly by reference to the opening inventory, and being taken in the order of acquisition, and depending upon the taxpayer's method of valuing its inventory increase for the preceding taxable year, will be computed as follows:

(*a*) In case the increase was taken as most recent purchases—

10	@ 10	(from 1938)	= 100
1	@ 13	(July, 1939)	= 13
2	@ 14	(October, 1939)	= 28
Totals: 13			141

or

(*b*) In case the increase was taken in order of acquisition—

10	@ 10	(from 1938)	= 100
1	@ 11	(January, 1939)	= 11
2	@ 12	(April, 1939)	= 24
Totals: 13			135

or

(*c*) In case increase was taken on basis of an average—

10	@ 10	(from 1938)	= 100
3	@ 13	(from 1939)	= 39
Totals: 13			139

(5) The taxpayer shall establish to the satisfaction of the Commissioner that the taxpayer [has not], in *ascer-*

taining income, profit, or loss for the taxable year for which the elective inventory method is first used or [in] *for* any subsequent taxable year, [used in determining income, profit, or loss,] for credit purposes [,] or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, *has not used* any inventory method other than that referred to in section 19.22(d)–1 or at variance with the requirement referred to in paragraph (3) of this section, the taxpayer's use of market value in lieu of cost *or his issuance of reports or credit statements covering a period of operations less than the whole of the taxable year* not being considered at variance with this requirement;*

(6) Goods of the specified type on hand as of the close of the taxable year preceding the taxable year for which this inventory method is first used, whether such preceding taxable year began before or after December 31, 1938, shall be included in the taxpayer's *closing* inventory for such preceding taxable year at cost *determined in the manner prescribed in paragraph (3) of this section;***

(7) The elective inventory method, once adopted by the taxpayer with the approval of the Commissioner, shall be adhered to in all subsequent taxable years unless—

(*a*) A change to a different method is approved by the Commissioner; or

(*b*) The Commissioner determines that the taxpayer [has used], in ascertaining income, profit[s], or loss *for the whole of any taxable year subsequent to his adoption of the elective inventory method*, for credit

*Material in brackets deleted and material in italics added by T. D. 5199, 1942-2 Cum. Bull. 81, 83.

**Material in italics added by T. D. 5163, 1942-2 Cum. Bull. 80.

purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, [and for years subsequent to his adoption of the elective inventory method,] *has used* any inventory method at variance with that referred to in section 19.22(d)-1, and requires of the taxpayer a change to a different method for such subsequent taxable year or any taxable year thereafter;* and

(8) [The taxpayer shall maintain such accounting records] *The records and accounts employed by the taxpayer in keeping his books shall be maintained in conformity with the inventory method referred to in section 19.22(d)-1; and such supplemental and detailed inventory records shall be maintained* as will enable the Commissioner readily to verify the taxpayer's inventory computations as well as his compliance with these several requirements.*

SEC. 19.22(d)-3. *Time and manner of making election.* The elective inventory method may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to *March 10, 1943*, the ninetieth day after the approval of Treasury Decision [4959, approved December 28, 1939] *5199*, then at any time prior to [the expiration of such ninetieth day] *such date)*, in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of

*Material in brackets deleted and material in italics added by T. D. 5199, 1942-2 Cum. Bull. 81, 84.

the end of the taxable year for which the elective method is proposed first to be used, and also as of the beginning of the preceding taxable year. In the case of a manufacturer, this analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products (whether in process or finished goods) into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in style, shape, or use of finished products. Each group of products shall be clearly described.*

The taxpayer shall submit for the consideration of the Commissioner in connection with the taxpayer's adoption or use of the elective inventory method such other detailed information with respect to his business or accounting system as may be at any time requested by the Commissioner.

As a condition to the taxpayer's use of the elective inventory method, the Commissioner may require that the method be used with respect to goods other than those specified in the taxpayer's statement of election if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income.

Whether or not the taxpayer's application for the adoption and use of the elective inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method will be determined by the Commissioner in connection with the examination of the taxpayer's returns.

SEC. 19.22(d)—4. *Adjustments to be made by taxpayer.* —A taxpayer may not change to the elective method of tak-

*Material in brackets deleted and material in italics added by T. D. 5199, 1942-2 Cum. Bull. 81, 84.

ing inventories unless, at the time he files his application for the adoption of such method, he agrees to such adjustments incident to the change to or from such method, or incident to the use of such method, in the inventories of prior taxable years or otherwise, as the Commissioner upon the examination of the taxpayer's returns may deem necessary in order that the true income of the taxpayer will be clearly reflected for the years involved.

SEC. 19.22(d)–5. *Revocation of election.*—An election made to adopt and use the elective inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years, unless the use of another method be required by the Commissioner, or authorized by him pursuant to a written application therefor filed with him as provided in section 19.41–2.

SEC. 19.22(d)–6. *Change from elective inventory method.*—If the taxpayer is granted permission by the Commissioner to discontinue the use of the elective method of taking inventories, and thereafter to pursue some other method, or if the taxpayer is required by the Commissioner to discontinue the use of the elective method by reason of the taxpayer's failure to conform to the requirements detailed in section 19.22(d)–2, the inventory of the specified goods for the first taxable year affected by the change and for each taxable year thereafter shall be taken—

(*a*) In conformity with the method used by the taxpayer under section 22(c) in inventorying goods not included in his elective inventory computations; or

(*b*) If the elective inventory method was used by the taxpayer with respect to all of his goods subject to inventory, then in conformity with the inventory method

used by the taxpayer prior to his adoption of the elective inventory method; or

(*c*) If the taxpayer had not used inventories prior to his adoption of the elective inventory method and had no goods currently subject to inventory by a method other than the elective method, then in conformity with such inventory method as may be selected by the taxpayer and approved by the Commissioner as resulting in a clear reflection of income; or

(*d*) In any event, in conformity with any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner.

SEC. 19.22(d)–1. *Inventories under elective method.*—Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22(c), and pursuant to the provisions of sections 19.22(c)–1 to 19.22(c)–8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22(d), as amended. Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

First, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged,

or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year beginning after December 31, 1938.

If the elective inventory method is used by a taxpayer who regularly and consistently, in a manner similar to hedging on a futures market, matches purchases with sales, then firm purchase and sales contracts (i.e., those not legally subject to cancellation by either party) entered into at fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that this practice is regularly and consistently adhered to by the taxpayer and that, in the opinion of the Commissioner, income is clearly reflected thereby.

*If a taxpayer using the retail method of pricing inventories, authorized by section 19.22(c)-8, elects to use in connection therewith the elective inventory method authorized by section 22(d) of the Code, the apparent cost of the goods on hand at the end of the year, determined pursuant to section 19.22(c)-8, shall be adjusted to the extent of price changes therein taking place subsequent to the close of the preceding taxable year. The amount of any apparent inventory increase or decrease to be eliminated in this adjustment shall be determined by reference to acceptable price indices established to the satisfaction of the Commissioner. Price indices prepared by the United States Bureau of Labor Statistics which are applicable to the goods in question will be considered acceptable to the Commissioner. Price indices which are based upon inadequate records, or which are not subject to complete and detailed audit within the Bureau, will not be approved.**

**Material in italics added by T. D. 5605, 1948-1 Cum. Bull. 16.

SEC. 19.22(d)-2. *Requirements incident to adoption and use of elective method.—Except as otherwise provided in section 19.22(d)-1 with respect to retail inventory computations,* the adoption and use of the elective inventory method is, by section 22(d) and regulations thereunder, made subject to the following requirements:*

(1) The taxpayer shall file an application to use such method specifying with particularity the goods to which it is to be applied;

(2) The inventory shall be taken at cost regardless of market values;

. . .

T.D. 5605, 1948-1 Cum. Bull. 16

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER A, PART 19 AND PART 29.

Regulations 103 and Regulations 111 amended with respect to elective inventory computations.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Collectors of Internal Revenue and Others Concerned:

On December 23, 1947, notice of proposed rule making regarding elective inventory computations in the case of retailers was published in the Federal Register (12 F. R. 8726). After consideration of all such relevant matter as was presented by interested persons regarding the proposal, the amendments to Regulations 103 [26 CFR, Part 19]

*Material in italics added by T. D. 5605, 1948-1 Cum. Bull. 16.

and to Regulations 111 [26 CFR, Part 29] set forth below are hereby adopted. The amendments are made in order to adapt the retail inventory requirements of the regulations to the elective inventory principle of section 22(d) of the Internal Revenue Code as enunciated by The Tax Court of the United States in *Hutzler Bros. Co.* (8 T. C., No. 3 [page 14]).

Paragraph 1. Section 29.22(c)-8 of Regulations 111 [26 CFR, 29.22(c)-8] and section 19.22(c)-8 of Regulations 103 as amended by Treasury Decision 5048, approved June 2, 1941 [C.B. 1941-1, 200] [26 CFR 19.22(c)-8], are further amended as follows:

(A) By inserting after the second paragraph in each case the following (except that, in Regulations 103, the cross-reference shall be made to section 19.22(d)-1):

For further adjustments to be made in the case of a retail merchant using the elective inventory method authorized by section 22(d), see section 29.22(d)-1.

(B) By striking from the beginning of the fourth paragraph in each case the words "A taxpayer," and by inserting in lieu thereof the following:

A taxpayer (other than one using the elective inventory method)

(C) By striking from the beginning of the last paragraph in each case the words "A taxpayer," and by inserting in lieu thereof the following:

A taxpayer (other than one using the elective inventory method)

(D) By inserting at the end thereof in each case the following:

A taxpayer using the elective inventory method in conjunction with retail computations must adjust retail selling prices for mark-downs as well as mark-ups, in order that there may be reflected the approximate cost of the goods on hand at the end of the year, regardless of market values.

Par. 2. Section 29.22(d)-1 of Regulations 111, as amended by Treasury Decision 5407, approved October 9, 1944 [C.B. 1944, 83] [26 CFR, 29.22(d)-1], and section 19.22(d)-1 of Regulations 103 [26 CFR, 19.22(d)-1] are further amended by inserting at the end thereof in each case the following (except that, in Regulations 103, the cross-reference shall be made to section 19.22(c)-8):

If a taxpayer using the retail method of pricing inventories, authorized by section 29.22(c)-8, elects to use in connection therewith the elective inventory method authorized by section 22(d) of the Code, the apparent cost of the goods on hand at the end of the year, determined pursuant to section 29.22(c)-8, shall be adjusted to the extent of price changes therein taking place subsequent to the close of the preceding taxable year. The amount of any apparent inventory increase or decrease to be eliminated in this adjustment shall be determined by reference to acceptable price indices established to the satisfaction of the Commissioner. Price indices prepared by the United States Bureau of Labor Statistics which are applicable to the goods in question will be considered acceptable to the Commissioner. Price indices which are based upon inadequate records, or which

are not subject to complete and detailed audit within the Bureau, will not be approved.

Par. 3. Section 29.22(d)-2 of Regulations 111, as amended by Treasury Decision 5504, approved March 20, 1946 [C.B. 1946-1, 52] [26 CFR, 29.22(d)-2], is further amended by revising that portion thereof preceding the numbered paragraphs to read as follows:

Sec. 29.22(d)-2. Requirements Incident to Adoption and Use of Elective Method.—Except as otherwise provided in section 29.22(d)-1 with respect to raw material computations and with respect to retail inventory computations, the adoption and use of the elective inventory method is, by section 22(d) and regulations thereunder, made subject to the following requirements:

Par. 4. Section 19.22(d)-2 of Regulations 103, as amended by Treasury Decision 5199, approved December 10, 1942 [C.B. 1942-2,81] [26 CFR, 19.22(d)-2], is further amended by revising that portion thereof preceding the numbered paragraphs to read as follows:

Sec. 19.22(d)-2. Requirements Incident to Adoption and Use of Elective Method.—Except as otherwise provided in section 19.22(d)-1 with respect to retail inventory computations, the adoption and use of the elective inventory method is, by section 22(d) and regulations thereunder, made subject to the following requirements:

Par. 5. The amendments made by this Treasury decision shall be applicable to all taxable years beginning after December 31, 1938.

(This Treasury decision is issued under the authority contained in sections 62 and 22(d) of the Internal Revenue Code (53 Stat., 32, 11; 26 U. S. C., 62, 22(d)).)

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved March 4, 1948.

A. L. M. WIGGINS,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 9, 1948, 8.55 a.m.)

Rulings

Mim. 6244, 1948-1 Cum. Bull. 21

Use of elective inventory method by taxpayers using retail inventory method.

TREASURY DEPARTMENT
OFFICE OF COMMISSIONER OF INTERNAL REVENUE.
Washington 25, D. C., March 9, 1948.

Collectors of Internal Revenue, Internal Revenue Agents in Charge; Heads of Field Divisions of the Technical Staff, and Others Concerned:

1. Section 22(d)(1) of the Internal Revenue Code provides an elective method for inventorying goods, commonly referred to as the last-in, first-out, or LIFO, inventory method. Section 22(d)(2)(A) of the Code provides that the elective method shall be applied only with respect to the goods specified by the taxpayer in an application filed with the Commissioner. The Commissioner's regulations

with respect to the elective inventory method have heretofore made no provision for retailers to group such goods into classes. The Bureau has held that the use of the elective inventory method was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method permitted under section 29.22(c)-8 of Regulations 111 and section 19.22(c)-8 of Regulations 103.

2. The Tax Court held in the case of *Hutzler Bros. Co. v. Commissioner* (8 T. C., 14) that a taxpayer using the retail inventory method is entitled to use the elective inventory method. The grouping of goods by classes under the retail inventory method necessarily involves the use of some type of index numbers for measuring the extent of price changes in the various classes of goods concerned. The decision laid down no rule concerning the nature or type of index numbers which might be proper, nor did it prescribe other details of methods for applying the Lifo method in the case of retail merchants.

3. Treasury Decision 5605, approved March 4, 1948 [page 16, this Bulletin], amends Regulations 103 and 111 to expressly permit the use of the elective inventory method by taxpayers using the retail inventory method. Certain principles are laid down for the application of the elective inventory method by such taxpayers. First, since the elective method requires the use of cost, the retail selling prices of goods included in the opening inventory and purchased during the year must be adjusted for mark-downs as well as mark-ups during the year without regard to the taxpayer's previous practice with respect to mark-downs under the retail method. This requirement does not apply to retailers employing the retail inventory method without the use of the elective method. Second, the price indices em-

ployed in the adjustment of the apparent cost of goods in the closing inventory for price changes taking place during the year must be shown, to the satisfaction of the Commissioner, to be acceptable. Any price indices must be based upon sound statistical principles of construction and upon adequate records to be kept available for examination by the Bureau.

4. Arrangements have been made between representatives of the retail trade and the United States Bureau of Labor Statistics for that agency to compute and publish a series of group index numbers of retail prices, on a country-wide basis, suitable for use by individual department stores, which will be acceptable to the Commissioner. These index numbers will cover the period from 1941 to the present on a semiannual basis, and will appear semiannually in the future. The use of such indices of the Bureau of Labor Statistics is not mandatory; indices may be prepared by an individual taxpayer based upon his own data on prices and inventory quantities, if adequate, and if proof is submitted that sound statistical methods have been employed that assure reliable indices, not only for the particular year in question, but for subsequent years. Retailers who have filed, on the basis of the elective method, returns for past years which are still open, and who used indices that are not acceptable to the Commissioner, may file amended returns employing acceptable indices.

5. Index numbers for the years ended January, 1941 to 1947, inclusive, were published by the Bureau of Labor Statistics on January 7, 1948, and similar data for July of those years was published on February 3, 1948. Semiannual indices for January 15 and July 15 will be published.

in the future, in March and September of each year. Indices as of the 15th of a month will be deemed to be representative of prices at either the beginning or end of such month. These releases of the Bureau of Labor Statistics will also be published in the Internal Revenue Bulletin.

6. The following groups have been used by the Bureau of Labor Statistics as the basis for the preparation of the indices for past years for use by department stores:

I. Piece goods, domestics, and draperies.
II. Shoes.
III. Ladies' underwear.
IV. Ladies' outerwear and girls' wear.
V. Men's and boys' wear.
VI. Furniture and bedding.
VII. Home furnishings.
VIII. Major appliances and electrical goods.
IX. Notions and toilet articles.

Beginning with January, 1948, price data will be gathered on additional commodities that may allow the segregation of additional groups. The Bureau of Labor Statistics shows in Table III of its release of January 7, 1948, the coverage of each of the above groups, by naming the departments of a typical department store, as described by the Controller's Congress of the National Retail Dry Goods Association, which are included in each group.

7. In using such group indices, a department store taxpayer will apply to the inventory data for each of his departments separately, in the manner described below, the index for the group in which the department logically belongs. A given group index may be applicable to a number of departments in a store.

8. The problem arises of what indices are to be employed for a department which does not fit into any one of the nine groups named above. In this case an index should be employed which represents an average for the whole of the remainder of the store. For example, this index may be the store total, as shown by the Bureau of Labor Statistics, or that shown for apparel, piece goods, and notions combined (groups I, II, III, IV, V, and IX), whichever of these combinations more closely represents the coverage of the inventory stock carried by the store.

9. The method of making the first-year price adjustments to the closing inventory values under the retail inventory method, combined with the elective (LIFO) method, is illustrated in Exhibits A and B, hereafter set forth, for three hypothetical departments. In the first two departments there was an increase in the physical quantity of inventory during the year in question, as shown by the comparison of the adjusted retail value at the end of the year and the retail value at the beginning of the year. In the first department prices rose during the year, as shown by the index, while in the second, prices fell. In the third department there was a decline in the physical quantity of inventory.

10. To illustrate further the principles involved, Exhibits C and D show the adjustments for two additional years for department 1, the data for the first year being repeated to show the continuity. It is assumed that the physical quantity of inventory increased in the first two years, but decreased in the third year, as indicated by the adjusted retail values. It is to be noted that the decrease in the third year eliminated all of the second year increase, and part of the first year's increase, *in that order*, retaining in the closing inventory the merchandise appearing in the

opening inventory "in the order of acquisition." Thus, it is necessary under the elective method to retain the identity of each annual increment to the inventory of each department. The price changes are measured by reference to the fixed prices at the beginning of the first LIFO year and the retail inventory value on each inventory date is adjusted to the price level on that date.

11. These illustrations are intended to show the main principles involved in the LIFO adjustments to retail inventories, and are not intended to cover all accounting details of computations which may be required, particularly in later years, under the elective method.

12. Correspondence regarding this mimeograph should refer to its number and the symbols indicated for the appropriate Bureau office concerned: Collectors of internal revenue, A&C: Col; internal revenue agents in charge, IT:EIM; and heads of field divisions of the Technical Staff, TS:ARM.

GEO. J. SCHOENEMAN,
Commissioner.

MISCELLANEOUS

The following is an extract, copied by hand from the files of the office of the United States Attorney for the Southern District of New York, of a press release prepared by Paul W. Williams, then the United States Attorney, summarizing the activities of his office for the fiscal year ended June 30, 1958:

JJL:sq

For release Mon. Morning papers
July 7, 1958

PRESS RELEASE

"Paul W. Williams, United States Attorney for the Southern District of New York, today released the annual statistical report of his office's operations for the fiscal year ending June 30, 1958. During this period Mr. Williams began 1,896 cases, of which 1,018 were criminal prosecutions, and he closed 1,956 cases, thus reducing by 60 the number of cases awaiting trial.

"* * *

"Civil litigation was equally successful, Mr. Williams reported. In proceedings in federal and State courts, he recovered civil judgments for the United States of $2,763,412.37, of which $645,936.39 has already been collected.

"In a recent tax refund action, R. H. Macy & Co. sought to recover $1,200,000.00 from the Federal Government for one tax year alone. The identical issue was involved in refund claims for five other tax years, and a victory for R. H. Macy & Co. would have resulted in a net loss to the Government of some $12,000,000.00. In addition, there were other department stores throughout the United

States with identical claims estimated variously between $300,000,000.00 and one billion dollars.

"Mr. Williams was successful in winning this action for the Government before the United States Court of Appeals for the Second Circuit. The complaint was dismissed, resulting in enormous savings to the Government.

"Mr. Williams praised the work of his staff and pointed to these accomplishments of the past fiscal year as indicative of the characteristic quality and quantity of the legal work performed by the office of the United States Attorney for the Southern District of New York."